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No.

In the Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

1. Whether Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), which allows the Secretary of Health and Human Services to promulgate "regulations * * * for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive," authorizes the Secretary to promulgate a retroactive regulation establishing a ceiling on reimbursement for hospitals' wage costs, and to apply that regulation in reimbursement proceedings not final at the time that the regulation was promulgated.

2. Whether the Administrative Procedure Act (APA), 5 U.S.C. (& Supp. IV) 551 *et seq.*, prohibits an agency from promulgating retroactive regulations even if the decision to apply a regulation retroactively is not arbitrary, capricious, an abuse of discretion, or otherwise contrary to law.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Howard University as Howard University Hospital, Tuscon Hospital Liquidating Corp. (formerly Tuscon General Hospital), Greater Southeast Community Hospital, Tuscon Medical Center, St. Cloud Hospital, and Community Hospital of Battle Creek were plaintiffs in actions in the district court. These parties also were appellees in the court of appeals.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Solicitor General, on behalf of the Secretary of Health and Human Services, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra,* 1a-19a) is reported at 821 F.2d 750. The opinion and order of the district court (App., *infra,* 20a-42a) are unreported.

JURISDICTION

The judgment of the court of appeals (App., *infra,* 43a-44a) was entered on June 26, 1987, and a petition for rehearing was denied on September 1, 1987 (App., *infra,* 45a-46a). On November 23, 1987, the Chief Justice entered an order extending the time for filing a petition for

a writ of certiorari to and including December 30, 1987. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTES INVOLVED

5 U.S.C. 551(4) provides in pertinent part:

For the purpose of this subchapter –

* * * * *

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency * * *.

42 U.S.C. (Supp. III). 1395x(v)(1)(A) provides in pertinent part:

The reasonable cost of any services shall be the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs for various types or classes of institutions, agencies, and services; * * *. Such regulations shall * * * (ii) provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

STATEMENT

1. At the time of the events at issue in this case, all "providers" of health care services to Medicare beneficiaries were reimbursed by the Secretary of Health and Human Services on an annual basis for the "reasonable cost" of those health care services. 42 U.S.C. (& Supp. III) 1395f(b), 1395x(u) and (v)(1)(A).[1] Congress expressly authorized the Secretary to promulgate regulations "establishing the method or methods to be used, and the items to be included, in determining" reasonable costs (42 U.S.C. (Supp. III) 1395x(v)(1)(A)). Alarmed by dramatic increases in the cost of hospital care, Congress in 1972 authorized the Secretary to "establish[ ] * * * limits on the * * * costs * * * to be recognized as reasonable" (42 U.S.C. (Supp. III) 1395x(v)(1)(A)). Thus, "based on estimates of the costs necessary in the efficient delivery of needed health services," the Secretary may by regulation limit both the types and amounts of costs that are reimbursable under the Medicare program (42 U.S.C. (Supp. III) 1395x(v)(1)(A)).

[1] A provider was reimbursed for its "customary charges" if those charges were less than the reasonable cost. 42 U.S.C. 1395f(b)(1).

Most hospitals are no longer reimbursed for inpatient services to Medicare beneficiaries solely on the basis of the "reasonable cost" incurred in providing services to Medicare patients. In Title VI of the Social Security Amendments of 1983, Pub. L. No. 98-21, §§ 601-607, 97 Stat. 149-172, Congress adopted the prospective payment system (PPS). Under PPS (which has been implemented over a four-year transition period beginning on October 1, 1983), hospitals are paid predetermined rates for specific services, which rates are not tied to specific costs incurred by the hospital in providing those services. See 42 U.S.C. (Supp. III) 1395ww(d), as amended by the Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, § 9102, 100 Stat. 155. Congress adopted PPS primarily "to reform the financial incentives hospitals face, promoting efficiency in the provision of services by rewarding cost/effective hospital practices" (H.R. Rep. 98-25, 98th Cong., 1st Sess. Pt. 1, at 132 (1983)). Many Medicare providers are not covered by the prospective payment system, however, and continue to obtain reimbursement for their "reasonable" costs. See pages 23-24, *infra*.

In 1979, the Secretary exercised his authority to establish cost limits by promulgating a regulation that prescribed ceilings upon Medicare reimbursement for hospitals' inpatient general routine operating costs. See 44 Fed. Reg. 31806 (1979). The regulation divided these costs into two categories: wage costs and all other costs. It fixed maximum reimbursable non-wage costs on a nationwide basis for various categories of hospitals; the rule also set nationwide wage cost ceilings, but made those cost limits subject to adjustment on a hospital-by-hospital basis to account for variations in wage rates over different geographic areas. The adjustment was made by applying to the nationwide wage cost ceilings an index derived from Bureau of Labor Statistics data for hospital wages in the particular geographic area. A particular hospital's wage cost ceiling was thus dependent upon the index number for that hospital's geographic area. *Id.* at 31807-31808.[2] The wage indices for each geographic area for hospital cost reporting periods beginning on or after July 1, 1979, were set forth in the regulation (*id.* at 31812-31813);[3] the 1980 indices were published one year later (45 Fed. Reg. 41868, 41875-41876 (1980)).

In 1981, the Secretary adjusted the formula used to calculate the wage indices by excluding data concerning

[2] As the court of appeals explained, "[t]he wage index for an individual hospital was to be calculated by dividing the 'local' average hospital wage by the 'national' average hospital wage"; "[i]f the hospital was located within a Standard Metropolitan Statistical Area ('SMSA'), the appropriate 'local' figure would be the average hospital wage within that SMSA, and the appropriate 'national' figure would be the average hospital wage among all SMSAs. If the hospital was located outside of a SMSA, the appropriate 'local' and 'national' figures would be calculated using non-SMSA wage data" (App., *infra,* 8a & n.9).

[3] The Secretary subsequently revised the cost limits for this period (see 44 Fed. Reg. 46949 (1979)).

the wages paid by hospitals owned by the federal government. See 46 Fed. Reg. 33638-33639 (1981). The Secretary explained that "[b]ecause these hospitals typically use national pay scales, the amounts they pay their employees do not necessarily reflect area wage levels. We believe excluding data from these hospitals will help improve the accuracy of the wage index adjustment" (*id.* at 33639).[4]

The Secretary viewed this refinement in the index methodology as a "minor technical change[ ]" (46 Fed. Reg. 33638 (1981)). He accordingly did not provide notice or an opportunity to comment before placing the revised index formula into effect. The Secretary further found that the public interest required that the new wage indices be placed into effect immediately: "the current [1980] limits would [otherwise] remain in effect without adjustment for cost reporting periods beginning after June 30, [1981] since there is no provision in the current schedule for adjusting the limits for cost reporting periods that begin after the date" (*id.* at 33640).

Several hospitals sought judicial review of the Secretary's action in the United States District Court for the District of Columbia, claiming that the Secretary had violated the Administrative Procedure Act, 5 U.S.C. (& Supp. IV) 551 *et seq.*, by failing to provide notice and an opportunity to comment before altering the wage index methodology. The court concluded that "the Secretary's decision to exempt the [decision to alter the index methodology] from notice and comment must be declared unlawful" (App., *infra,* 60a). Citing the provisions of the Medicare Act limiting the availability of judical review,

[4] The Secretary also used approximate, rather than actual index values for 26 geographic areas because the Bureau of Labor Statistics could not supply actual data for those areas (46 Fed. Reg. 33638-33639 (1981)).

the district court declined to issue an injunction barring the application of the 1981 wage indices to the plaintiffs' reimbursement claims. It instead issued an order declaring that the revised wage indices were "invalid" (App., *infra,* 66a).

In February 1984, the Secretary issued a notice of proposed rulemaking proposing the reissuance of the 1981 wage indices. See 49 Fed. Reg. 6175 (1984). The notice stated that the indices set forth in the proposed rule would apply to cost reporting periods beginning on or after July 1, 1981 and ending after September 30, 1981, but would not apply to reporting periods beginning on or after October 1, 1982 (*ibid.*).[5] Thus, "the rule was to apply to cost accounting periods that would have been covered prospectively by the Secretary's 1981 rule had that rule been promulgated in accordance with the procedural requirements of the APA" (App., *infra,* 9a).

The Secretary stated (49 Fed. Reg. 6177 (1984)) that

> the exclusion of Federal government hospital data would improve the accuracy of the wage index because most Federal hospitals characteristically employ physicians and other high salaried professionals whose salaries are based on national rather than local wage scales. This factor tends to overstate the average hospital wage in areas with Federal institutions as compared to areas without such Federal facilities. Since the purpose of the wage index is to reflect area-by-area differences in the labor-related component of hospital costs, the exclusion of Federal hospital data better enables the wage index to accurately reflect area-by-area labor-related costs.

The Secretary observed that where non-federal hospitals pay wages similar to those paid by the federal government,

[5] Reimbursement of routine inpatient costs for those later cost periods is governed by different rules. See 49 Fed. Reg. 6175 (1984).

the data from non-federal hospitals would reflect those wages, and "the exclusion of Federal wages would have little effect on the wage index" (*ibid.*). If, on the other hand, "wages paid to Federal hospital employees are higher than most area hospital wage levels, then the inclusion of Federal data results in most hospitals receiving a higher Medicare cost limit than is warranted based on their expected costs. Such a result defeats the purpose of the cost limits, which is to limit a provider's reimbursement to only those costs necessary in the efficient delivery of needed health services" (*ibid.*).

The Secretary stated that the reissuance of the 1981 wage indices, which had been calculated without wage data from federally-owned hospitals, "avoids placing an unwarranted hardship and burden on intermediaries and many hospitals, while it would impose only a minimal burden on a few hospitals" (49 Fed. Reg. 6177 (1984)). Because "[t]he inclusion of Federal data in the wage index at this point in time would result in overpayments to many hospitals," intermediaries might be forced to review already-settled cost reports and hospitals that had received excess reimbursement would be required to repay these sums to the government (*ibid.*). "In contrast, those few hospitals that would receive less reimbursement if Federal hospital data are excluded from the wage index would not be unduly harmed or burdened by the reissuance of the wage index," because those hospitals could only have relied on the wage indices published in 1981 (*ibid.*). "Since these limits are prospectively established and published in advance, all hospitals knew before the beginning of their respective cost reporting periods what their cost limit would be. * * * This proposed notice would simply put the previously set cost limits back into effect" (*ibid.*).

After considering comments submitted by interested parties, the Secretary reaffirmed the propriety of the change in index methodology and reissued the 1981 wage

indices in final form (49 Fed. Reg. 46495 (1984)). She rejected the contention that the application of the 1984 rule to 1981 cost years constituted an impermissible retroactive rule, observing that "as a practical matter hospitals could only have relied on the [1981] rule in determining their respective cost limits" for the cost periods that would be covered by the 1984 rule (*id.* at 46497). Because "[e]ach hospital [therefore] knew in advance of its cost reporting period what its cost limit would be for this period," the Secretary concluded that the 1984 rule could properly be applied to 1981 cost reporting periods (*ibid.*).

2. Respondents are health care providers that operate hospitals. Respondents' fiscal intermediaries applied the 1984 wage indices to recoup funds previously reimbursed to respondents under wage indices that included federal hospital wage data. Respondents obtained the necessary certification from the Provider Reimbursement Review Board and commenced several actions in the United States District Court for the District of Columbia challenging the Secretary's decision to apply the revised index calculation methodology to their 1981 cost periods (see 42 U.S.C. (Supp. III) 1395*oo*(f)(1)). The district court consolidated the actions and entered judgment in favor of respondents. The court declined to address respondents' claims that the Secretary lacked the statutory authority to issue retroactive rules. Instead, the court held that the decision to apply the 1981 wage indices retroactively was invalid on the facts of this case. See App., *infra,* 20a-42a.

In so ruling, the district court applied the five-factor balancing test set forth in *Retail, Wholesale & Dep't Store Union* v. *NLRB,* 466 F.2d 380, 388 (D.C. Cir. 1972), to determine whether the rule could properly be given retroactive effect. The court concluded (App., *infra,* 38a) that "the balancing of factors in this case compels the conclusion that Medicare statute interests are only minimally served, if at all, by the Secretary's retroactive application

of his reissued wage index to recoup funds from these plaintiffs. In contrast, the ill effects of the Secretary's actions are substantial for these plaintiffs and for the general integrity of the administrative rule-making process. Accordingly, retroactive application against these plaintiffs must be denied."

3. The court of appeals affirmed, but rested its decision upon grounds different from those adopted by the district court (App., *infra,* 1a-19a). The court acknowledged that adjudicatory orders issued by administrative agencies may be given retroactive effect. But, citing the Administrative Procedure Act's definition of a "rule" as "an agency statement of general or particular applicability and *future effect*" (5 U.S.C. 551(4) (emphasis added)), the court concluded that "the APA requires that legislative rules be given future effect only. Because of this clear statutory command, equitable considerations are irrelevant to the determination of whether the Secretary's rule may be applied retroactively; such retroactive application is foreclosed by the express terms of the APA" (App., *infra,* 11a-12a, 13a).

The court stated that when the district court invalidated the 1981 rule, "it necessarily reinstated the Secretary's *1979* rule, which required the Secretary to reimburse providers using a formula that included federal-hospital data" (App., *infra,* 13a (emphasis in original)). "The Secretary's 1984 rule obviously can have no application to cost accounting periods that were, by virtue of the District Court's ruling, governed by the Secretary's 1979 rule" (*ibid.*). In the Court's view, "agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to reissue that rule on a retroactive basis" (*id.* at 14a). The court acknowledged that if an agency rule is invalidated on procedural grounds, "the agency must, of course, be given an opportunity to correct the procedural defect and prom-

ulgate a new rule"; but "the corrected rule, like all other legislative rules, [must] be prospective in effect only" (*ibid.*).[6]

The court of appeals stated that Congress may "override the general terms of the APA by explicitly authorizing retroactive regulations in an agency's organic statute" (App., *infra,* 14a). Petitioner contended that the retroactive 1984 regulation was specifically authorized by Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), which empowers the Secretary of Health and Human Services to issue "regulations" that "provide for the making of suitable retroactive corrective adjustments where * * * the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." The court of appeals rejected that argument, however, holding that "Congress did *not* intend to empower the Secretary to promulgate retroactive cost-limit rules" (App., *infra,* 15a (emphasis in original)). As an initial matter, the court stated that "[i]t was not until the litigation in the district court that the Secretary sought to invoke the retroactive adjustments provision as authority for the rule" (App., *infra,* 16a). Because the provision was not explicitly cited when the 1984 rule was promulgated, the court thought that it could not be invoked to justify that rule.

With respect to the merits of this argument, the court of appeals discerned "a critical distinction between the power to promulgate retroactive rules of general application and the power to make retroactive corrective adjustments in

[6] In its order denying the petition for rehearing, the court of appeals stated that "[a]s a general rule, the APA requires that legislative rules be given future effect only. Whatever exceptions might exist to this general rule were not implicated in the case before us. Our opinion therefore does not purport to address circumstances in which there may be an exception to the rule against retroactive rulemaking" (App., *infra,* 45a).

the reimbursements of particular providers whose aggregate reimbursement is shown to be either 'inadequate or excessive' " in case-by-case evidentiary proceedings (App., *infra,* 17a). It concluded that Section 1861(v)(1)(A)(ii) confers only the latter power upon the Secretary, authorizing him to make retroactive adjustments to individual reimbursement determinations where he is able to "prove that inadequate or excessive reimbursements to a provider have resulted from his 'methods of determining costs' " (App., *infra,* 18a (citation omitted)). In the absence of individualized proof that the reimbursement awarded respondents exceeded their reasonable costs, the court held that the Secretary had no authority to adjust those reimbursement awards retroactively (*id.* at 18a-19a).

REASONS FOR GRANTING THE PETITION

This case concerns an issue of considerable importance to the administration of the Medicare program—whether the Secretary of Health and Human Services may give retroactive effect to regulations setting the amount of reimbursement that may be paid to providers of health services to Medicare beneficiaries. It is important to note at the outset that, while the rule at issue in this case does operate retroactively in the technical sense that it governs reimbursement for costs incurred by respondents prior to the date upon which the rule was promulgated, that retroactive effect has none of the qualities that have led the courts to take a cautious view of the retroactive application of legal standards. The wage indices at issue here were initially promulgated as an entirely prospective regulation issued in 1981. When that regulation was invalidated by the district court on procedural grounds in 1983, the Secretary decided not to appeal that determination; instead—after subjecting the regulation to prior notice and com-

ment—she reissued the regulation in 1984 and gave the revalidated regulation the same 1981 effective date as the original regulation. Because the identical substantive standard had been adopted in 1981, all hospitals affected by the 1984 rule—including respondents—were plainly on notice *before they incurred the costs subject to the 1984 rule* that the reasonableness of those costs would be measured against the standard contained in that rule.

Despite the fact that respondents can therefore demonstrate no prejudice of any kind from the Secretary's decision to give retroactive effect to the reissued rule, the court of appeals held that both the Medicare Act and the Administrative Procedure Act barred the Secretary from applying the rule on a retroactive basis. In reaching that result, the court of appeals adopted constructions of these statutes that squarely conflict with the decisions of numerous other courts of appeals. With respect to the Medicare Act, the court's determination cannot be reconciled with the express statutory language authorizing retroactive administrative action. And the court's unprecedented interpretation of the Administrative Procedure Act, precluding federal administrative agencies from engaging in virtually any retroactive rulemaking, is similarly at odds with that statute's language and legislative history.

The scope of the Secretary's authority to give retroactive effect to rules governing Medicare cost reimbursement is a matter of considerable practical importance. In carrying out his statutory mandate to ensure that reimbursement neither exceeds nor falls short of a provider's reasonable costs, the Secretary may learn that a prior cost reimbursement methodology was flawed—either in favor of providers or to their detriment—and conclude that retroactive adjustment of reimbursement awards is therefore appropriate. By prohibiting the Secretary from making such adjustments through rules of general application, and requiring the Secretary to engage in a separate adjudi-

cation for each individual provider (in which it would be necessary to prove both the flaws in the old reimbursement methodology and the propriety of the new standard) the decision of the court below would effectively eliminate the only realistic method available to the Secretary to make retroactive corrections to reimbursement decisions. Moreover, the effect of the court's erroneous construction of the Administrative Procedure Act is not confined to the Medicare context; it dramatically reduces the rulemaking authority of all federal agencies, barring retroactive rulemaking in essentially all circumstances regardless of the balance between the public interest and any prejudice to the affected parties. For all of these reasons, review by this Court is plainly warranted.[7]

1. a. Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), empowers the Secretary of Health and Human Services to issue regulations that "provide for the making of suitable retroactive corrective adjustments where * * * the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." There is a considerable disagreement among the courts of appeals regarding the scope of the Secretary's authority under this provision. Some court of appeals have concluded that "[u]pon determining that one of his cost reimbursement regulations produces inadequate or excessive payments to providers, the Secretary has a statutory duty [under Section 1861(v)(1)(A)(ii)] to make suitable retroactive corrective adjustments" through the issuance of regulations (*Springdale Convalescent Center* v. *Mathews*, 545 F.2d 943, 954 (5th Cir. 1977)). These courts have held that the

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[7] This case does not raise the jurisdictional problem presented in *Bowen* v. *Commonwealth of Massachusetts*, petition for cert. pending, No. 87-712, because the applicable waiver of sovereign immunity is contained in 42 U.S.C. (& Supp. III) 1395*oo*(f), not the Administrative Procedure Act or the Tucker Act.

Secretary may—and in some circumstances must—apply revised cost reimbursement regulations retroactively where the prior rule resulted in an improper level of reimbursement. *Ibid.*; see also *Regents of the University of California* v. *Heckler*, 771 F.2d 1182, 1188-1189 (9th Cir. 1985); *Fairfax Nursing Center, Inc.* v. *Califano*, 590 F.2d 1297, 1300 (4th Cir. 1979); *Hazelwood Chronic & Convalescent Hospital, Inc.* v. *Weinberger*, 543 F.2d 703, 707-708 (9th Cir. 1976), vacated on other grounds, 430 U.S. 952 (1977); *Whitecliff, Inc.* v. *United States*, 536 F.2d 347, 352 (Ct. Cl. 1976), cert. denied, 430 U.S. 969 (1977); *Kingsbrook Jewish Medical Center* v. *Richardson*, 486 F.2d 663, 669-670 (2d Cir. 1973); cf. *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d 1435, 1453-1454 & n.36 (11th Cir. 1987), petition for cert. pending, No. 87-380 (applying balancing test to determine whether rule may be applied retroactively); *Mason General Hospital* v. *Secretary of Health & Human Services*, 809 F.2d 1220, 1225-1226 (6th Cir. 1987) (same).

The court below took a narrower view of Section 1861(v)(1)(A)(ii), holding that the provision does not empower the Secretary to issue retroactive rules, but only authorizes retroactive adjustment of reimbursement awards on a case-by-case basis upon proof that a particular reimbursement award was either inadequate or excessive. App., *infra*, 16a-19a; see also *St. Paul-Ramsey Medical Center* v. *Bowen*, 816 F.2d 417, 419-420 (8th Cir. 1987) (holding that the Secretary has a duty to make retroactive adjustments without stating whether such adjustments may be made by regulation). A third group of courts has stated that the provision does not permit any retroactive reassessment of reimbursement decisions, but only directs the Secretary "to promulgate regulations that mandate retroactive adjustments in the *payments* received by providers, so as to bring the amounts paid to them on the basis of their monthly estimates in line with the amount actually due them under the annual audit."

Daughters of Miriam Center for the Aged v. *Mathews*, 590 F.2d 1250, 1258 n.23 (3d Cir. 1978) (emphasis in original); see also *Adams Nursing Home of Williamstown, Inc.* v. *Mathews*, 548 F.2d 1077, 1082 (1st Cir. 1977). On this view of Section 1861(v)(1)(A)(ii), the provision simply requires the Secretary to establish a mechanism for reconciling the Secretary's advance estimated payments with the amount finally determined to be due the provider following review of the provider's annual cost report.[8]

b. Section 1861(v)(1)(A)(ii) expressly authorizes the Secretary to issue regulations that "provide for the making of suitable retroactive corrective adjustments" in reimbursement awards. Where, as here, the Secretary concludes that application of a cost reimbursement regulation has resulted in either an excessive or inadequate reimbursement award, the statute by its plain language permits the Secretary to issue a retroactive regulation to adjust the erroneous reimbursement determination as long as that course of action is reasonable. Nothing in the language of the statute supports the court of appeals' conclusion that the Secretary may retroactively reexamine reimbursement decisions on a case-by-case basis, but may not issue retroactive rules of general application; the statute expressly authorizes the issuance of *regulations* providing for retroactive readjustments in reimbursement determinations.[9]

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[8] Indeed, the courts of appeals have themselves recognized the existence of a conflict regarding the proper interpretation of Section 1861(v)(1)(A)(ii). *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d at 1454 n.36; *Daughters of Miriam Center for the Aged* v. *Mathews*, 590 F.2d at 1258-1259 n.23; App., *infra*, 16a (footnote omitted) (court below observed that its "sister circuits have struggled to define the precise contours of the retroactive corrective adjustments provision"); see also *id.* at 34a (district court opinion).

[9] The court of appeals stated that the Secretary could not rely upon Section 1861(v)(1)(A)(ii) because "[i]t was not until the litigation

Not only is the court of appeals' interpretation at odds with the language of the statute, it is wholly unrealistic. It would permit retroactive adjustments to reimbursement determinations identical to that achieved by the 1984 rule, but only if the Secretary makes those adjustments in separate, individualized proceedings for each provider. In view of the vast scope of the Medicare program, that approach is simply unworkable. See *City of Austin* v. *Heckler*, 753 F.2d 1307, 1317 (5th Cir. 1985) ("regulation [of Medicare reimbursement] cannot be accomplished on a hospital-by-hospital basis"). If, as the court appears to agree, retroactive adjustments are permissible, then the Secretary must have the authority to make those adjustments in an administratively practicable manner. Because the Secretary can utilize regulations to set cost limits as an initial manner, it makes no sense to bar the Secretary from using regulations to adjust reimbursement awards retroactively.

The court of appeals rested its construction of the statute in part upon the legislative history of the 1972

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in the District Court that the Secretary sought to invoke the retroactive corrective adjustments provision as authority for the rule" (App., *infra*, 16a). But the Secretary did expressly invoke Section 1861(v), 42 U.S.C. (& Supp. III) 1395x(v)—of which Section 1861(v)(1)(A)(ii) is a subsection—as authority for the issuance of the 1984 rule. See 49 Fed. Reg. 6180 (1984); *id.* at 46501. Surely the Secretary is not required to separately list every subsection upon which he specifically relies in promulgating a rule. In any event, this Court has stated that an agency's failure to invoke the proper statutory authority for administrative action does not invalidate that action where the "mistake of the administrative body is one that clearly had no bearing on the procedure used or the substance of the decision reached." *Massachusetts Trustees* v. *United States*, 377 U.S. 235, 247-248 (1964); see also *NLRB* v. *Wyman-Gordon, Co.*, 394 U.S. 759, 767 n.6 (1969); *People of Illinois* v. *ICC*, 722 F.2d 1341, 1348-1349 (7th Cir. 1983); cf. *Baylor University Medical Center* v. *Heckler*, 758 F.2d 1052, 1060 n.14 (5th Cir. 1985). That principle plainly applies here.

amendment to the Medicare statute that authorized the Secretary to promulgate cost limits such as the regulation at issue here (see page 3, *supra*), citing a statement in the congressional committee reports to the effect that this authority " 'would be exercised on a prospective, rather than retrospective, basis, so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable' " (App., *infra*, 15a (citations omitted)).

As a threshold matter, we are not certain that this legislative history is relevant in interpreting Section 1861(v)(1)(A)(ii), which was included in the original Medicare statute enacted in 1965, and thus was not enacted as part of the 1972 amendments. Even if the legislative history is relevant, however, it does not change the result here because respondents had ample notice of the very cost limits adopted in 1984 before those limits were placed into effect. As we have discussed (see pages 11-12, *supra*), the substantive standard contained in the 1984 regulation was first issued as a prospective rule in 1981. Indeed, that 1981 rule remained undisturbed for the entire time period affected by the retroactive rule—the cost periods beginning after July 1981 and before October 1982—because the rule was not invalidated by the district court until 1983. Thus, respondents obviously were on notice that the reasonableness of their costs would be assessed against the standard set forth in the 1984 rule.[10]

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[10] The court of appeals suggested (App., *infra*, 12a n.11) that the Secretary's interpretation of the statute is flawed because it would allow the Secretary to make his regulations retroactive for an unlimited period of time. But Section 1861(v)(1)(A)(ii) does not override other provisions of the Medicare Act. Thus, when a reimbursement award is final and no longer subject to reopening (see 42 C.F.R. 405.1885), that award cannot be reconsidered pursuant to a rule issued

2. Even if the Secretary's express authority to alter reimbursement decisions retroactively does not empower the Secretary to issue retroactive rules of the type at issue here, the Secretary's action should be upheld as an exercise of his general rulemaking authority under the Medicare Act (see 42 U.S.C. (& Supp. III) 1395x(v)(1)(A), 1395hh) and the Administrative Procedure Act. The court of appeals' contrary determination—which rests on the novel conclusion that the APA prohibits virtually all retroactive rulemaking—should be reviewed by this Court.[11]

a. The decision of the court of appeals regarding the authority of a federal administrative agency to accord retroactive effect to one of its rules conflicts with the decisions of other courts of appeals with respect to that question. The court below stands alone in holding that, as a general matter, a rule promulgated pursuant to the Administrative Procedure Act may not be given retroactive effect (see App., *infra,* 13a). The other courts of appeals to address the question have stated that an agency's decision to give a rule retroactive effect may be upheld if that decision is found to be reasonable after assessment of the public and private interests affected by the decision to apply the rule retroactively. See, *e.g., Texaco, Inc.* v. *De-*

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under Section 1861(v)(1)(A)(ii). See 51 Fed. Reg. 11188 (1986) (stating that retroactive application of medical malpractice cost standard is limited to cost reports not yet closed and costs reports still subject to reopening).

[11] The court of appeals initially stated that all retroactive rulemaking was prohibited by the APA (see App., *infra,* 13a). In its order denying the petition for rehearing, the court indicated that there might be some exceptions to this "general rule," but declined to state what those exceptions might be (*id.* at 45a). That vague order does little to alleviate the impact of the court's decision and it does nothing to eliminate the fundamental error in the court's legal analysis—the conclusion that the APA contains an independent limitation upon retroactive rulemaking.

partment of Energy, 795 F.2d 1021, 1025-1027 (Temp. Emer. Ct. App. 1986), cert. dismissed, No. 86-187 (Aug. 19, 1986); *National Ass'n of Independent Television Producers & Distributors* v. *FCC,* 502 F.2d 249, 255 nn. 10, 11 (2d Cir. 1974); *Daughters of Miriam Center for the Aged* v. *Mathews,* 590 F.2d at 1259-1260 (interpretive rule); *General Telephone Co.* v. *United States,* 449 F.2d 846, 863 (5th Cir. 1971); cf. *Illinois* v. *Bowen,* 786 F.2d 288, 292 (7th Cir. 1986) (upholding retroactive application of agency's new interpretation of existing rule). Prior decisions of the District of Columbia Circuit were to the same effect. *Citizens To Save Spencer County* v. *EPA,* 600 F.2d 844, 879-881 (D.C. Cir. 1979); see also *Maxcell Telecom Plus, Inc.* v. *FCC,* 815 F.2d 1551, 1554-1556 (D.C. Cir. 1987).

b. The court of appeals' interpretation of the Administrative Procedure Act is clearly wrong. The court of appeals relied (App., *infra,* 11a-12a) upon the statutory definition of a "rule," which states that a rule is "the whole or any part of any agency statement of general or particular applicability and future effect" designed to implement law or policy or describe the agency's organization and procedure (5 U.S.C. 551(4)). Seizing upon the phrase "future effect," the court concluded that a rule may not be given retroactive effect. But the legislative history of Section 551(4) makes plain that Congress did not intend to impose any such general restriction upon rulemaking authority. The reference to "future effect" was designed to distinguish rulemaking from adjudication, not to prohibit retroactive application of rules as a matter of course (see *Colyer* v. *Harris,* 519 F. Supp. 692, 694 (S.D. Ohio 1981)). Thus, under the APA, a "rule" is a statement of law or policy which is not applied or enforced in the same proceeding in which it is announced; any application or enforcement will occur *only in the future, i.e.,* in an adjudication.

This understanding is confirmed by the report of the ~~House Judiciary Committee, which added the phrase of the~~ House Judiciary Committee, which added the phrase "future effect" to the statutory definition of "rule." The committee's report explains that "[t]he phrase 'future effect' does not preclude agencies from considering and, so far as legally authorized, dealing with past transactions in prescribing rules for the future." H.R. Rep. 1980, 79th Cong., 2d Sess. App. A, n.1 (1946), *reprinted in, Legislative History of the Administrative Procedure Act, 1944-46,* at 283 n.1; see also *Attorney General's Manual on the Administrative Procedure Act* 37 (1947) ("[n]othing in the Act precludes the issuance of retroactive rules when otherwise legal and accompanied by" a finding of good cause).

The court of appeals also justified its interpretation of the APA by stating that retroactive rulemaking to correct an agency's procedural misstep is "completely at odds with basic tenets of administrative law" because "the effect of invalidating an agency rule is to '*reinstat[e]* the rules previously in force.' " App., *infra,* 13a (quoting *Action on Smoking & Health* v. *CAB,* 713 F.2d 795, 797 (D.C. Cir. 1983) (emphasis in the original)). But the court's premise is incorrect; invalidation of a rule does not generally reinstate the rules previously in force. Rather, the agency is free to reconsider the entire matter, with its decision subject to further judicial review. See *Burlington Northern, Inc.* v. *United States,* 459 U.S. 131, 142-144 (1982); *Motor Vehicle Manufacturers Ass'n* v. *State Farm Mutual Automobile Insurance Co.,* 463 U.S. 29, 57 & n.21 (1983); *Addison* v. *Holly Hill Fruit Products, Inc.,* 322 U.S. 607, 619-620 (1944); *Williams* v. *Washington Metropolitan Area Transit Comm'n,* 415 F.2d 922, 939-940 (D.C. Cir. 1968) (en banc), cert. denied, 393 U.S. 1081 (1969). Accordingly, the administrative agency is free to decide in the first instance whether to apply prior law to a case covered by the invalidated regulation or give retroactive effect to a subsequently-promulgated regulation. By completely eliminating administrative discretion to determine whether to accord retroactive effect to a rule, it is the court of appeals that has ignored basic principles of administrative law.[12]

The fact that retroactive rulemaking is permissible under the APA does not, of course, mean that an agency's decision to give a rule retroactive effect must be upheld in every case. The decision to apply the rule retroactively must be set aside if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" (5 U.S.C. 706(2)(A)). The threshold inquiry is whether the substantive statute granting rulemaking authority imposes any restriction upon the agency's authority to apply rules retroactively. If no such limitation exists, a court must consider whether the agency's decision is arbitrary and capricious. The touchstone for that inquiry is this Court's decision in *SEC* v. *Chenery Corp.,* 332 U.S. 194 (1947), which upheld the retroactive application of a new principle of law in the context of an adjudication. The Court there stated that "such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal or equitable principles. If that

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[12] Contrary to the court of appeals' apparent belief, *Action on Smoking & Health* v. *CAB, supra,* did not purport to establish a general principle that invalidation of a rule automatically reinstates the pre-existing rule. Rather, the reinstatement of the prior rule in that case was ordered only because an agency had engaged in "repeated technical noncompliance" with the APA (713 F.2d at 802). The court's general principle is also plainly unworkable. It would reimpose a prior regulation that the agency had already found to be unsatisfactory and that might be contrary to intervening statutory provisions. The agency must exercise its expertise to determine in the first instance the suitable course of action following a remand. Cf. *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council, Inc.,* 435 U.S. 519 (1978) (holding that a court may not impose additional procedural requirements on an agency).

mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law" (332 U.S. at 203). Other courts have elaborated upon the application of this balancing test in the rulemaking context. See, *e.g.*, *Texaco, Inc.* v. *Department of Energy*, 795 F.2d at 1025-1027; *Citizens to Save Spencer County* v. *EPA*, 600 F.2d at 879-881.

In addition, the retroactive application of the rule must be consistent with the Constitution. The Court has concluded that "[t]he retroactive aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former" (*Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 16-17 (1976)). That due process standard requires a "showing that the retroactive application of the [regulation] is itself justified by a rational * * * purpose" (*Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, 467 U.S. 717, 730 (1984)).

These tests are satisfied here. As we have discussed (see pages 11-12, *supra*), prior to incurring any of the costs that are subject to the 1984 rule, respondents had ample notice that the reasonableness of those costs would be assessed against the standard contained in that rule. Thus, respondents can have no reliance interest because the governing standard at the time they incurred the relevant costs was the standard that is contained in the current rule. In addition, the public interest weighs strongly in favor of applying the rule retroactively. Otherwise, respondents would gain a windfall—approximately $2 million in excess reimbursement.[13]

[13] The district court reached a contrary conclusion in applying the balancing test set forth in *Retail, Wholesale & Dep't Store Union* v. *NLRB*, *supra* (see App., *infra*, 35a-39a). Its analysis was flawed by its failure to recognize that respondents' reliance interest must be assessed as of the time they engaged in the underlying conduct. The court erroneously concluded that respondents had a cognizable reliance interest in retaining the windfall they obtained by virtue of the application of the flawed reimbursement standard. Cf. *Heckler* v. *Community Health Service of Crawford County, Inc.*, 467 U.S. 51 (1984). The court also erred in finding that the public interest weighed against the application of the revised methodology for calculation of the indices without first finding that that methodology was substantively invalid. If the methodology is valid, it is, by definition, the proper approach for calculating "reasonable" cost. Any award in excess of that amount violates the statute and therefore cannot be supported by the public interest.

3. The issues presented in this case are of considerable practical significance. The Secretary is obligated to administer the Medicare program in a manner that ensures that providers will be reimbursed for reasonable costs, as defined by the Secretary, and no more. See 42 U.S.C. (& Supp. III) 1395f(b). Because the decision of the court of appeals effectively deprives the Secretary of any realistic ability to adjust flawed reimbursement methodologies on a retroactive basis, even in the face of practical experience or audit data establishing the flaws in those methods, it will greatly hamper the Secretary's ability to perform his statutory duty. If defective cost reimbursement rules allow providers such as respondents to reap a windfall—or force them to suffer a shortfall—the Secretary simply will not be able to adjust those awards.[14]

Although the reasonable cost system of reimbursement for Medicare services has been replaced to some extent by the prospective payment system (see note 1, *supra*), many Medicare providers continue to obtain reimbursement for their "reasonable" costs by filing cost reports. See 42 C.F.R. 412.20-412.32 (rehabilitation hospitals, psychiatric

[14] The District of Columbia Circuit's limited view of the Secretary's authority is especially significant because the Medicare statute permits any provider to seek judicial review of a reimbursement determination in that Circuit (see 42 U.S.C. (Supp. III) 1395*oo*(f)(1)).

hospitals, children's hospitals, and hospitals with average length of stay greater than 25 days are not covered by PPS), 42 C.F.R. 413.1 (reasonable cost payment system applies to skilled nursing facilities, home health agencies, and other facilities providing services other than in-hospital care). Moreover, all providers are reimbursed for some categories of costs on a reasonable cost basis. See, *e.g.*, 42 U.S.C. (Supp. III) 1395ww(a)(4) (anesthesia services provided by nurse); 42 C.F.R. 412.2(d) (capital costs, direct medical education costs, cost for direct medical and surgical services provided by certain physicians in teaching hospitals). The questions presented here regarding the Secretary's authority to adjust reimbursement awards on a retroactive basis therefore have continuing importance for the administration of the Medicare program.[15]

The implications of the court of appeals' construction of the Administrative Procedure Act range far beyond the Medicare context. The court's decision seriously limits the regulatory authority of virtually every federal administrative agency.[16] By precluding retroactive rulemaking to correct procedural or technical missteps, the decision below permits plaintiffs, such as respondents here, to bootstrap procedural errors into substantive limitations upon the exercise of agency authority. That result will adversely affect an agency's ability to carry out its congressional mandate. The decision will also affect the government's litigating posture and the caseload of the federal appellate courts. If an agency cannot retroactively correct even an insignificant procedural error, the government will be forced to seek review of many more adverse lower court decisions in order to protect the agency's regulatory authority. The decision below thus threatens to burden the courts with issues that otherwise would have been resolved in the administrative process. For all of these reasons, review by this Court is plainly warranted.

[15] In addition, many disputes concerning hospitals' claims for reimbursement under the reasonable cost system are now pending on administrative and judicial review. The Department of Health and Human Services informs us that many of these cases involve challenges to the Secretary's authority to promulgate retroactive cost limit regulations.

[16] And, because almost all government agencies are subject to suit under the APA in the District of Columbia Circuit (see 28 U.S.C. 1391(e)), the court's decision will have nationwide impact.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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DECEMBER 1987

* The Solicitor General is disqualified in this case.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 86-5381

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

No. 86-5382

HOWARD UNIVERSITY
AS HOWARD UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

No. 86-5383

TUSCON GENERAL HOSPITAL

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

Appeals from the United States District Court
for the District of Columbia
(Civil Action Nos. 85-1845, 85-2545 and 85-2862)

Argued March 30, 1987
Decided June 26, 1987

Before: EDWARDS and STARR, *Circuit Judges,* and SWYGERT,* *Senior Circuit Judge,* United States Court of Appeals for the Seventh Circuit.

Opinion for the Court filed by *Circuit Judge* EDWARDS.

EDWARDS, *Circuit Judge*: In 1979, the Secretary of the Department of Health, Education and Welfare,[1] acting pursuant to section 223(b) of the Social Security Amendments of 1972,[2] promulgated a number of "cost limit" rules applicable to providers of routine inpatient hospital Medicare services. *See* 44 Fed. Reg. 31,806 (1979). The rules established limits on the amount of money that providers would be able to claim from the federal government as reimbursement for the costs incurred in the provision of Medicare services. Among the rules promulgated by the Secretary was a "wage index" formula, which would be used to calculate the cap on reimbursable wage costs. By its terms, the wage-index rule was to apply prospectively to cost accounting periods beginning on or after July 1, 1979. *Id.* at 31,806.

Two years later, in 1981, the Secretary modified the wage-index formula to exclude certain data that, in his view, reduced the accuracy of the index. *See* 46 Fed. Reg. 33,637, 33,639 (1981). The Secretary did so, however, without allowing for a notice and comment period. The

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* Sitting by designation pursuant to 28 U.S.C. § 294(d) (1982).

[1] Now the Department of Health and Human Services or "HHS."

[2] Codified at 42 U.S.C. § 1395x(v)(1)(A) (1982).

appellees—seven non-profit hospitals that provide routine inpatient Medicare services—challenged the Secretary's action in the District Court on the ground that notice and an opportunity for comment were required by section 553 of the Administrative Procedure Act ("APA"), 5 U.S.C. § 553 (1982). The trial court agreed with the appellees' contention and struck down the rule as violative of the APA. *See District of Columbia Hosp. Ass'n v. Heckler,* No. 82-2520, slip op. (D.D.C. Apr. 29, 1983), *reprinted in* Joint Appendix ("J.A.") 44-64; *Saint Cloud Hosp. v. Heckler,* No. 83-0223, slip op. (D.D.C. May 2, 1983), *reprinted in* J.A. 65-66. No appeal was taken from this ruling, and the Secretary, acting through fiscal intermediaries,[3] settled the appellees' accounts using the 1979 wage-index rule.

Three years later, the Secretary "reissued" the 1981 wage-index rule, this time adhering to the notice and comment procedures mandated by the APA. *See* 49 Fed. Reg. 46,495 (1984). Like the 1979 and 1981 cost-limit rules, the 1984 rule was promulgated under the authority of section 223(b). *See Proposed Notice,* 49 Fed. Reg. 6175, 6176 (1984). Unlike the 1979 and 1981 rules, however, the 1984 rule was given *retroactive* effect. Specifically, the rule was to cover cost accounting periods beginning on or after July 1, 1981—precisely those cost accounting periods that *would have been covered prospectively* by the Secretary's 1981 rule had that rule been promulgated in conformity with the procedural requirements of the APA. Pursuant to the retroactive rule, the fiscal intermediaries recalculated

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[3] 42 U.S.C. § 1395g(a) (1982) requires the Secretary to reimburse providers periodically during the fiscal year based on estimated costs for the year. At the end of the fiscal year, the Secretary is to make any "necessary adjustments on account of previously made overpayments or underpayments." The Secretary has contracted out these statutory responsibilities to insurance companies known as "fiscal intermediaries."

the amount owing to the appellees and recouped an amount in excess of two million dollars.

The appellees again filed suit in the District Court, challenging both the rule's retroactive application and its substantive validity. The District Court held that the reissued wage index was invalid insofar as it was applied to recoup monies from the appellees, and ordered the Secretary to reimburse the appellees with interest. *See Georgetown Univ. Hosp. v. Bowen*, No. 85-1845, slip op. at 24 (D.D.C. Apr. 11, 1986), *reprinted in* J.A. 94, 117. In reaching this result, the District Court principally concluded that the retroactive application of the rule was barred by the equitable principles enumerated by this circuit in *Retail, Wholesale & Department Store Union v. NLRB* ("*Retail Union*"), 466 F.2d 380 (D.C. Cir. 1972).[4]

We agree with the District Court that the Secretary's retroactive application of the 1984 cost-limit rule cannot stand, but we base our conclusion solely on the applicable provisions of the APA and the Medicare Act, and not on the equitable balancing test adopted by this circuit in *Retail Union*. The principles enunciated in *Retail Union* govern only those situations where a new policy is announced in the course of an administrative adjudication and applied retroactively to the participants in that adjudication. It does not apply in those situations where a

[4] The District Court was ambivalent about whether the Secretary had the statutory authority to promulgate a retroactive cost-limit rule. On the one hand, the court found that the APA and the Medicare Act seemed to preclude the issuance of such a retroactive rule. Slip op. at 15-16, *reprinted in* J.A. 108-09. On the other hand, the court observed that 42 U.S.C. § 1395x(v)(1)(A)(ii) (1982), which authorizes the Secretary to provide in his regulations for the "making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive," arguably contemplated some degree of retroactive rulemaking authority. *Id.* at 16-17, *reprinted in* J.A. 109-10.

"legislative" rule is promulgated in accordance with the rulemaking procedures set forth in the APA. In these latter situations, a reviewing court must look both to the APA and to the agency's organic statute to discern the scope of the agency's rulemaking authority. When we do so in the instant case, we find that the Secretary's actions were clearly precluded both by the APA and the Medicare Act. Accordingly, we affirm the judgment of the District Court.

I. BACKGROUND

A. *Statutory Background*

The Medicare program, which subsidizes the medical care of the elderly and the infirm, was enacted by Congress in 1965 as Title XVIII of the Social Security Act. *See* Social Security Amendments of 1965, Pub. L. No. 89-97, 79 Stat. 286. Under the program, providers of covered services, such as hospitals and nursing homes, are generally reimbursed for "the lesser of (A) the reasonable cost of such services, as determined under section 1395x(v) . . . or (B) the customary charges with respect to such services." 42 U.S.C. § 1395f(b)(1) (1982 & Supp. III 1985). The instant case concerns only the "reasonable cost" provisions of 42 U.S.C. § 1395x(v).

As amended in 1972, section 1395x(v)(1)(A) defines "reasonable cost" as the "cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services." The statute, however, does not require the Secretary to calculate the reasonable cost of Medicare services on a provider-by-provider basis. Rather, the Secretary is empowered to estimate the reasonable cost of providers by issuing regulations of general applicability. These regulations—denominated by statute as the "methods to be used . . . in determining . . . costs"—are presumed to measure

accurately that proportion of a provider's total costs that are attributable to the efficient treatment of Medicare beneficiaries. However, the Secretary is empowered by section 1395x(v)(1)(A)(ii) to provide in his regulations "for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." [5]

Prior to the 1972 amendments to section 1395x(v)(1)(A), the Secretary's ability to determine accurately the *reasonable cost* incurred by Medicare providers was somewhat limited. As the statute was originally drafted, the Secretary was empowered to establish cost accounting "methods" that would separate a provider's Medicare-related costs from its non-Medicare related costs.[6] However, the Secretary was *not* authorized to promulgate regulations determining—on a prospective basis—*what level* of Medicare-related costs would be considered "reasonable," and hence reimbursable.[7]

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[5] Section 1395x(v)(1)(A)(ii) will be referred to throughout the remainder of this opinion as the "retroactive corrective adjustments provision."

[6] *See* S. Rep. No. 404, 89th Cong., 1st Sess. 36, *reprinted in* 1965 U.S. CODE CONG. & ADMIN. NEWS 1943, 1976:

> Although [reimbursement] may be made on various bases the objective, whatever method of computation is used, will be to approximate as closely as practicable the actual cost (both direct and indirect) of services rendered to the beneficiaries of the program so that under any method of determining costs, the costs of services of individuals covered by the program will not be borne by individuals not covered, and the costs of services of individuals not covered will not be borne by the program.

[7] As the statute was originally drafted, the Secretary *did* have the authority to reduce reimbursements for those "items or services which are in excess of or more than" what would be considered "reasonable" under the Medicare Act. Pub. L. No. 89-97, § 1861(v)(2)(B), 79 Stat. 286, 323 (1965). However, this power was rarely exercised, both because of the difficulty of proving on a case-by-case basis that a particular item or service was excessively priced, and the "financial uncertainty" to providers caused by the retroactive disallowance of incurred costs. *See* S. Rep. No. 1230, 92d Cong., 2d Sess. 188 (1972) ("*Senate Report*"); H.R. Rep. No. 231, 92d Cong., 1st Sess. 83, *reprinted in* 1972 U.S. CODE CONG. & ADMIN. NEWS 4989, 5069-70 ("*House Report*").

To remedy this perceived deficiency in the statutory scheme, Congress amended section 1395x(v)(1)(A) in 1972 to authorize the Secretary to promulgate regulations establishing "limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services." *See* Social Security Amendments of 1972, Pub. L. No. 92-603, § 223(b), 86 Stat. 1329, 1393. In amending the statute, both Houses of Congress made clear their intent that this new authority was to be exercised on a prospective basis only: "[The authority] to set limits on costs . . . would be exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." *Senate Report* at 188; *House Report* at 83, *reprinted in* 1972 U.S. CODE CONG. & ADMIN. NEWS at 5070. Thus, by virtue of this amendment, the Secretary's statutory authority to establish "methods of determining costs" extends to the promulgation of prospective "cost limit" rules. *See Regents of the Univ. of Cal. v. Heckler,* 771 F.2d 1182, 1189 (9th Cir. 1985) ("The 1972 amendments, in authorizing the Secretary to adopt cost limits, merely added another method of cost calculation to those already recognized as legitimate by the statute.").

B. *Factual Background*

The cost-limit rule at issue in this case was first promulgated by the Secretary in 1979, explicitly pursuant to his statutory authority "to set prospective limits on the costs that are reimbursed under Medicare." 44 Fed. Reg. 31,806, 31,806 (1979). The rule, which governed only the provision of routine inpatient hospital services,[8] established a wage-index formula to be used to calculate the cap on reimbursable wage costs. The wage index for an individual hospital was to be calculated by dividing the "local" average hospital wage by the "national" average hospital wage.[9] Bureau of Labor Statistics ("BLS") data was to be used in calculating the applicable indexes. *See id.* at 31,807-08.

In 1981, the Secretary made an adjustment to the formula used to calculate the wage indexes. Specifically, the Secretary decided to exclude data on the wages paid by federally-owned hospitals. *See* 46 Fed. Reg. 33,637, 33,639 (1981). The Secretary reasoned that the wage-index formula—which was designed to measure variations in local wage rates—would be more accurate without the inclusion of this wage data, because federally-owned hospitals typically paid their employees according to

[8] In 1983, Congress enacted a new "prospective payment system" to be used by the Secretary in determining the appropriate level of reimbursement for inpatient hospital services. *See* 42 U.S.C. § 1395ww(d) (Supp. III 1985). Under that new system, providers of inpatient hospital services are reimbursed on the basis of predetermined rates. This change does not affect the instant appeal, which concerns only reimbursements for costs incurred prior to 1983.

[9] If the hospital was located within a Standard Metropolitan Statistical Area ("SMSA"), the appropriate "local" figure would be the average hospital wage within that SMSA, and the appropriate "national" figure would be the average hospital wage among all SMSAs. If the hospital was located outside of a SMSA, the appropriate "local" and "national" figures would be calculated using non-SMSA wage data.

national rather than local wage rates. *Id.* at 33,639. The Secretary made this revision in his cost-limit rule without allowing for a notice and comment period.

The appellees filed two separate actions in the District Court seeking to overturn the rule on the ground that the Secretary had failed to comply with the procedural requirements of section 553 of the APA, 5 U.S.C. § 553 (1982). The trial court found in favor of the appellees and invalidated the rule. *See District of Columbia Hosp. Ass'n v. Heckler,* No. 82-2520, slip op. (D.D.C. Apr. 29, 1983), *reprinted in* J.A. 44-64; *Saint Cloud Hosp. v. Heckler,* No. 83-0223, slip op. (D.D.C. May 2, 1983), *reprinted in* J.A. 65-66. The Secretary filed an appeal from the trial court's ruling, but voluntarily dismissed the appeal on September 1, 1983. Pursuant to the trial court's decision, the fiscal intermediaries settled the appellees' accounts using the Secretary's original wage-index formula, *i.e.*, the wage-index formula that *included* federal-hospital data.

In February of 1984, the Secretary published a Notice of Proposed Rulemaking in which he proposed to "re-issue" the 1981 wage-index rule. 49 Fed. Reg. 6175 (1984). Although the notice explicitly stated that the Secretary was authorized by statute to establish "prospective" cost-limit rules, the "reissued" rule was to apply retroactively to cost accounting periods dating back to July of 1981. *Id.* In other words, the rule was to apply to cost accounting periods that would have been covered prospectively by the Secretary's 1981 rule had that rule been promulgated in accordance with the procedural requirements of the APA.

After a comment period, the Secretary published a final notice announcing his decision to "reissue" the 1981 wage-index rule. 49 Fed. Reg. 46,495 (1984). In rejecting the contention of one commenter that he was without authority to promulgate a retroactive rule, the Secretary opined that the rule was not truly "retroactive" in nature, because hospitals were on notice in 1981 that he intended to ex-

clude federal-hospital data from the wage index. *Id.* at 46,497. Under the circumstances, the Secretary viewed the "retroactive" rule as a legitimate attempt to correct the procedural defect that had prompted the District Court to invalidate the rule in the first instance. *Id.*

Pursuant to the rule, the Secretary instructed the fiscal intermediaries to reopen earlier cost accounting periods and recalculate the amount owing to the appellees using a wage-index formula that *excluded* federal-hospital data. The fiscal intermediaries did so, recouping an amount in excess of two million dollars from the seven appellee hospitals. The appellees again filed suit in the District Court, which invalidated the Secretary's action on the ground that retroactive application of the 1984 rule violated the equitable principles enunciated by this court in *Retail Union. See Georgetown Univ. Hosp. v. Bowen,* No. 85-1845, slip op. at 17-22 (D.D.C. Apr. 11, 1986), *reprinted in* J.A. 94, 110-15. The Secretary filed this appeal.

II. ANALYSIS

A. *The Secretary's Retroactive Rule Was Barred by the APA*

In its opinion, the District Court found that both the APA and the Medicare Act appeared to preclude the Secretary from promulgating a retroactive cost-limit rule. However, the court declined to rest its judgment on that ground. Perceiving conflicting signals from Congress on the question of the Secretary's statutory authority, *see* note 4 *supra,* the trial court turned to this circuit's decision in *Retail Union,* where we articulated certain equitable considerations relevant to the question whether an agency may give retroactive effect to new policies adopted in the course of *adjudication.*[10] Based on the considerations

[10] Those equitable considerations include: (1) whether the issue raised in the adjudication is one of first impression; (2) whether the new policy is an abrupt departure from well-established agency practice; (3) the extent to which the parties to the adjudication relied on the old policy; and (4) the burden imposed on the parties by retroactive application of the new policy. These considerations must be balanced against the statutory interest in applying the new policy retroactively. *See* 466 F.2d at 390.

enumerated in *Retail Union,* the trial court held that the Secretary's rule was invalid insofar as it was applied to recoup monies from the appellees.

We uphold the judgment of the District Court, but for reasons distinct from those identified in *Retail Union.* In *Retail Union,* the court was careful to distinguish between new policies adopted in the course of adjudication, and rules adopted pursuant to rulemaking procedures under the APA. Policies adopted in the course of adjudication, the court held, may be applied retroactively, unless the inequities produced by retroactive application are not counterbalanced by sufficiently significant statutory interests. *See* 466 F.2d at 390; *cf. Yakima Valley Cablevision, Inc. v. FCC,* 794 F.2d 737, 745-46 (D.C. Cir. 1986) (noting the "troubling nature" of retroactive policymaking, and observing that this court, beginning with *Retail Union,* "has developed factors to guide our determination of whether an agency may give retroactive effect to a new policy developed in adjudication"). The court in *Retail Union* went on to observe, however, that Congress had devised an "*alternative procedure,*" *i.e.,* rulemaking under the APA, by which the inequities of retroactive policymaking could be avoided altogether. 466 F.2d at 388 (emphasis added). The court made clear that a balancing of the equities is unnecessary in those situations where this "alternative procedure" is utilized, because rules adopted pursuant to rulemaking procedures under the APA are to be "prospective in application only." *Id.* (citing the definitional section of the APA, 5 U.S.C. § 551 (1982), which distinguishes a "rule" from an "adjudication," and defines

the former as "an agency statement of general or particular applicability and *future effect*" (emphasis added)); *cf. SEC. v. Chenery Corp.*, 332 (U.S. 194, 202 (1947) (distinguishing between the "quasi-legislative promulgation of [general] rules to be applied in the future," and adjudicatory orders that may in appropriate circumstances, be given retroactive effect); *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1166 (D.C. Cir. 1985) (distinguishing between trial-type procedures and "notice and comment rulemaking, [which is] particularly appropriate for determination of legislative facts and policy of general, prospective applicability"), *cert. denied*, 106 S. Ct. 1968 (1986); *Telocator Network of America v. FCC*, 691 F.2d 525, 551 (D.C. Cir. 1982) (same); *PBW Stock Exchange, Inc. v. SEC*, 485 F.2d 718, 732 (3d Cir. 1973) ("[R]ules ordinarily look to the future and are applied prospectively only. . . ."), *cert. denied*, 416 U.S. 969 (1974).[11]

[11] The fact that the APA requires legislative rules to be given only "future effect" is underscored by 5 U.S.C. § 553(d) (1982), which requires that such rules be published not less than 30 days before their effective date, except "as otherwise provided by the agency for good cause found and published with the rule." On one occasion, this circuit has suggested that, in unique circumstances, the "good cause" exception to the 30-day effective date requirement might justify legislative rules of limited retroactive effect. *See Citizens to Save Spencer County v. EPA*, 600 F.2d 844, 879-81 (D.C. Cir. 1979). The decision in *Spencer County* is not only extremely limited, but the narrow exception that it purports to recognize has never been accepted by any other panel of this court. This is hardly surprising, because § 553(d) appears only to contemplate a narrow exception to the 30-day requirement for rules that, for good cause shown, must be given effect either immediately upon promulgation, or in less than 30 days; neither § 553(d), nor any other provision of the APA, permits rules of retrospective effect.

In any event, we need not examine the precise meaning of § 553(d) here, because the reasons advanced by the Secretary in his notice for promulgating a retroactive rule plainly do not bring that rule within any conceivable "good cause" exception.

The instant case does not in any way involve a new agency policy articulated in the course of adjudication. Rather, it involves a *legislative rule* adopted by the Secretary pursuant to the notice and comment procedures of the APA, 5 U.S.C. § 553 (1982). As recognized in *Retail Union* itself, the APA requires that legislative rules be given future effect only. Because of this clear statutory command, equitable considerations are irrelevant to the determination of whether the Secretary's rule may be applied retroactively; such retroactive application is foreclosed by the express terms of the APA.

In his final rulemaking notice, the Secretary suggested that a retroactive rule was warranted under the circumstances of this case to correct what was simply a "procedural defect" in his previous rule. *See* 49 Fed. Reg. 46,495, 46,497 (1984). It is clear, however, that this proffered exception to the requirement that legislative rules be prospective in effect only is completely at odds with basic tenets of administrative law. This circuit has previously held that the effect of invalidating an agency rule is to "*reinstat[e]* the rules previously in force." *Action on Smoking & Health v. CAB*, 713 F.2d 795, 797 (D.C. Cir. 1983) (emphasis added); *accord Menorah Medical Center v. Heckler*, 768 F.2d 292, 297 (8th Cir. 1985); *Abington Memorial Hosp. v. Heckler*, 750 F.2d 242, 244 (3d Cir. 1984), *cert. denied*, 106 S. Ct. 180 (1985). Accordingly, when the District Court vacated the Secretary's *1981* wage-index rule, it necessarily reinstated the Secretary's *1979* rule, which required the Secretary to reimburse providers using a formula that included federal-hospital data. Well aware of the import of the District Court's ruling, the Secretary reimbursed the appellee hospitals using the 1979 wage-index formula. The Secretary's 1984 rule obviously can have no application to cost accounting periods that were, by virtue of the District Court's ruling, governed by the Secretary's 1979 rule. *Cf. Greene v. United States*, 376

U.S. 149, 160 (1964) (because 1955 regulation was in effect when the petitioner's claim to monetary compensation was asserted, the government could not compel the petitioner to establish his entitlement to compensation under a revised 1960 regulation).

The Secretary's suggestion that retroactive rulemaking is permissible to remedy a procedural defect in a rule would, if accepted, make a mockery of the provisions of the APA. Obviously, agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to "reissue" that rule on a retroactive basis. If an agency rule is invalidated on procedural grounds, the agency must, of course, be given an opportunity to correct the procedural defect and promulgate a new rule. *See, e.g., Action on Smoking & Health,* 713 F.2d at 798. However, both the express terms of the APA and the integrity of the rulemaking process demand that the corrected rule, like all other legislative rules, be prospective in effect only.

B. *The Secretary's Retroactive Rule is Also Inconsistent With the Medicare Act*

Although Congress has expressed a clear intention in the APA not to authorize retroactive agency rulemaking, Congress may—subject to any applicable constitutional constraints[12]—override the general terms of the APA by explicitly authorizing retroactive regulations in an agency's organic statute. However, just as substantive legislation will not be given retroactive effect "unless such be 'the unequivocal and inflexible import of the [statutory] terms,

[12] *See generally* Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation,* 73 HARV. L. REV. 692 (1960); Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking,* 48 CALIF. L. REV. 216 (1960).

and the manifest intention of the legislature,' "[13] an organic statute will not be read to authorize an agency to engage in retroactive rulemaking unless it is clear from the terms of the statute that Congress intended such an unusual delegation of power. In the instant case, it is clear from the terms and the legislative history of the Medicare Act that Congress did *not* intend to empower the Secretary to promulgate retroactive cost-limit rules. Thus, the Secretary's actions in this case are barred not only by the APA, but by the Medicare Act as well.

As outlined earlier, Congress amended section 1395x(v)(1)(A) of the Medicare Act in 1972 to authorize the Secretary to promulgate cost-limit regulations. In amending the statute, both Houses of Congress made it abundantly clear that this authority was to be exercised on a prospective basis only: "[The authority] to set limits on costs . . . would be exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." *Senate Report* at 188; *House Report* at 83, *reprinted in* 1972 U.S. CODE CONG. & ADMIN. NEWS at 5070.

Since 1972, the Secretary has consistently interpreted section 1395x(v)(1)(A) to authorize cost-limit rules that are prospective in application only. *See, e.g.,* 42 C.F.R. § 413.30 (1986); *Beth Israel Hosp. v. Blue Cross Assoc.,* [1981-1982 Transfer Binder] Medicare & Medicaid Guide (CCH) ¶ 31,645, at 10,136-37 (Nov. 7, 1981). Indeed, on each occasion that the Secretary has promulgated a wage-index rule—*including the rule challenged here on the grounds of retroactivity*—the Secretary has explicitly noted that he is authorized by statute to establish *prospec-*

[13] *Greene v. United States,* 376 U.S. 149, 160 (1964) (quoting *Union Pac. R.R. v. Laramie Stock Yards Co.,* 231 U.S. 190, 199 (1913)).

tive cost-limit rules. In light of the clear congressional intent, and the uninterrupted agency practice, we are astonished that the Secretary now purports to have the authority to promulgate such rules on a retroactive basis.

At no point in this litigation, either in the District Court or on appeal, has the Secretary disputed the fact that Congress amended the Medicare Act in 1972 to authorize *prospective* cost-limit rules. Nevertheless, the Secretary contends that a retroactive cost-limit rule was authorized under the present circumstances by section 1395x(v)(1)(A)(ii), the retroactive corrective adjustments provision. We cannot agree.

First, we note that the Secretary explicitly promulgated the retroactive rule under section 223 of the Social Security Amendments of 1972—the very provision that Congress added to the Medicare Act to authorize *prospective* cost-limit rules. It was not until the litigation in the District Court that the Secretary sought to invoke the retroactive corrective adjustments provision as authority for the rule. In light of the APA's requirement that notice of proposed rules contain "reference to the legal authority under which the rule is proposed," 5 U.S.C. § 553(b)(2) (1982), and that final rules be accompanied by "a concise general statement of their *basis* and purpose," *id.* § 553(c) (emphasis added), the Secretary's belated attempt to justify the rule under the retroactive corrective adjustments provision must fail.

Second, even if we were to entertain the Secretary's belated invocation of section 1395x(v)(1)(A)(ii), we would conclude that the Secretary's actions here were not authorized by the statute. Although our sister circuits have struggled to define the precise contours of the retroactive corrective adjustments provision,[14] that provision is

[14] *See, e.g., Tallahassee Memorial Regional Medical Center v. Bowen,* 815 F.2d 1435 (11th Cir. 1987); *Mason Gen. Hosp. v. Secretary of HHS,* 809 F.2d 1220 (6th Cir. 1987); *Regents of the Univ. of Cal. v. Heckler,* 771 F.2d 1182 (9th Cir. 1985); *Fairfax Nursing Center v. Califano,* 590 F.2d 1297 (4th Cir. 1979); *Daughters of Miriam Center for the Aged v. Mathews,* 590 F.2d 1250 (3d Cir. 1978); *Adams Nursing Home v. Mathews,* 548 F.2d 1077 (1st Cir. 1977); *Springdale Convalescent Center v. Mathews,* 545 F.2d 943 (5th Cir. 1977); *Kingsbrook Jewish Medical Center v. Richardson,* 486 F.2d 663 (2d Cir. 1973).

plainly *not*—as the Secretary would have it—broad authority for the promulgation of retroactive cost-limit rules. Rather, the provision is narrowly drawn to allow the Secretary to make "*corrective adjustments* where, *for a provider of services* for any fiscal period, the aggregate reimbursement produced by the [Secretary's] methods of determining costs *proves to be* either inadequate or excessive." 42 U.S.C. § 1395x(v)(1)(A)(ii) (emphasis added).

As the highlighted language illustrates, there is a critical distinction between the power to promulgate retroactive rules of general application and the power to make retroactive corrective adjustments in the reimbursements of particular providers whose aggregate reimbursements are shown to be either "inadequate or excessive." The former power—if it existed—would be exceedingly broad, for it would permit the Secretary to issue a modified cost-limit rule, and then automatically apply that rule across the board to all providers who had been reimbursed under the predecessor rule. The latter power, however, is far more limited, for it only allows the Secretary to adjust the reimbursements of particular providers upon proof that his "methods of determining costs" (including his cost-limit rules) resulted in inadequate or excessive reimbursements to those providers.

To emphasize the importance of this distinction, it is necessary to focus in on the workings of the statutory scheme. As outlined earlier, the Secretary's "methods of determining costs" are the means by which the Secretary estimates the "reasonable cost" incurred by all providers of Medicare services, defined by statute as the "cost actually

incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services." 42 U.S.C. § 1395x(v)(1)(A) (1982). Like any measuring device, the Secretary's regulations will be subject to a certain degree of error, inevitably resulting in "inadequate" or "excessive" reimbursements to *some providers*. Where the Secretary is able to prove that inadequate or excessive reimbursements to a provider have resulted from his "methods of determining costs," he may make "suitable retroactive corrective adjustments." *Id.* § 1395x(v)(1)(A)(ii).[15]

The administrative record is devoid of any indication that corrective adjustments in the appellees' reimbursements were warranted on the facts of this case.[16] Absent

[15] Although the Secretary is authorized by statute to make retroactive corrective adjustments, we reject out of hand the Secretary's contention that the exercise of such authority is subject to no time limitation. The Secretary infers the absence of any temporal restriction on his authority to make retroactive adjustments from the use of the phrase "*any* fiscal period" in § 1395x(v)(1)(A)(ii) (emphasis added). We agree with the Eleventh and Sixth Circuits, however, that the use of the word "any" does not suggest that the Secretary has the awesome power to reopen a provider's account years or even decades after that account has been settled. *See Tallahassee Memorial Regional Medical Center v. Bowen*, 815 F.2d 1435, 1453-54 (11th Cir. 1987); *Mason Gen. Hosp. v. Secretary of HHS*, 809 F.2d 1220, 1225-26 (6th Cir. 1987). Had Congress intended to delegate such boundless authority to the Secretary, it would, we submit, have said so more directly and unambiguously.

[16] The fact that the appellees arguably are entitled to lower reimbursements under the Secretary's new rule does *not* establish that they were reimbursed in excess of their reasonable costs under the prior rule. It is equally plausible that the Secretary's new rule understates the reasonable costs incurred by the appellees in prior cost accounting periods, as the appellees have maintained throughout this litigation.

The appellees argue—and the District Court specifically found—that the Secretary's new wage-index rule understates their reasonable costs, principally because the index does not distinguish

an evidentiary showing that the appellees received excessive reimbursements under the prior wage-index rule, there was no basis for even a timely invocation of the retroactive corrective adjustments provision. We therefore hold that the Secretary acted in contravention of the APA and the Medicare Act by recouping past reimbursements from the appellees, and that those reimbursements must be restored.

III. CONCLUSION

For the reasons set forth above, the judgment of the District Court is

Affirmed.

between those hospitals located within the urban "core" of a SMSA, and those hospitals located within the suburban "ring" of a SMSA (the purported distinction being that hospitals in urban cores are forced to pay higher wages to entice talented personnel). *See* Brief of Plaintiffs/Appellees at 39-45; *Georgetown Univ. Hosp. v. Bowen*, No. 85-1845, slip op. at 19-20 (D.D.C. Apr. 11, 1986), *reprinted in* J.A. 94, 112-13; *see also Final Notice*, 49 Fed. Reg. 46,495, 46,498 (1984) (conceding that a wage index that differentiates urban "cores" from suburban "rings" could "[i]n principle" provide a "more precise" wage index, but finding that such an index is infeasible "due to certain limitations of the BLS data used to construct the wage index"). Whether the appellees are indeed correct in this assertion, however, is irrelevant to the proper disposition of this appeal. The Secretary's actions here must fail because he made no attempt to demonstrate that the appellees had received excessive reimbursements under the prior rule, and therefore laid no foundation for the application of the retroactive corrective adjustments provision. Only if the Secretary had attempted such an evidentiary showing would we need to examine the appellees' substantive claims.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 85-1845

GEORGETOWN UNIVERSITY HOSPITAL, ET AL., PLAINTIFFS

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

Civil Action No. 85-2545

HOWARD UNIVERSITY
AS HOWARD UNIVERSITY HOSPITAL, ET AL., PLAINTIFFS

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

Civil Action No. 85-2862

TUSCON GENERAL HOSPITAL, PLAINTIFF

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

[Filed Apr. 11, 1986]

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* Otis R. Bowen is substituted for Margaret M. Heckler pursuant to Fed. R. Civ. P. 25(d).

MEMORANDUM

Plaintiff health care providers in these consolidated cases challenge the retroactive wage index rule published by the Secretary of Health and Human Services on November 26, 1984. Fiscal intermediaries, applying this retroactive wage index rule, have recouped monies previously paid to plaintiffs. Plaintiffs seek a determination that the retroactive wage index rule is invalid, and reimbursement of the monies recouped under that rule by the fiscal intermediaries. Presently before the Court are the parties' cross motions for summary judgment. All issues have been thoroughly briefed and orally argued.

I.

This suit continues a controversy that commenced in 1981 when the Secretary published a schedule of Medicare routine cost limits without having first published notice and received comments. For each of the seven years before 1981 the Secretary had published an annual schedule of limits on hospital costs reimbursable under the Medicare Act only after publishing a notice of proposed rulemaking and receiving comments solicited by that notice, pursuant to the Administrative Procedure Act ("APA"), 5 U.S.C. § 553. On June 30, 1981, however, the Secretary published a "Final Notice" of the 1981 "Schedule of Limits on Hospital . . . Costs," 46 Fed. Reg. 33637 (June 30, 1981), without having first published notice and received comments. Significantly, the 1981 schedule used a formula for calculating the hospital wage index that excluded data from federal hospitals in the Standard Metropolitan Statistical Area ("SMSA").

The preamble to the June 30 Notice stated

> In developing the wage index used for the revised limits, we have also excluded data from federal government hospitals. Because these hospitals typi-

> cally use national pay scales, the amounts they pay their employees do not necessarily reflect area wage levels. We believe excluding data from these hospitals will help improve the accuracy of the wage index adjustment.

46 Fed. Reg. at 33639.

The Secretary's June 30, 1981 wage index rule was challenged in a suit filed in this Court on September 9, 1982, by three District of Columbia hospitals and the District of Columbia Hospital Association, which represented the interests of fifteen similar hospitals in the District of Columbia. Each of those hospitals would have been reimbursed less under the Secretary's 1981 wage index rule than they would have been under the pre-existing wage index, which included federal hospital data.

By Memorandum and Order of April 29, 1983, this Court invalidated the Secretary's June 30, 1981 wage index rule because it was promulgated without notice and comment. *District of Columbia Hospital Association [DCHA] v. Heckler,* No. 82-2520, slip op. (D.D.C. April 29, 1983). That Memorandum stated:

> If the Secretary wishes to put in place a valid *prospective* wage index, she should begin proper notice and comment proceedings; any wage index currently in place that has been promulgated without notice and comment is invalid as was the 1981 schedule.

Id. at 19 (emphasis added) (footnote omitted). The April 29 decision became final on September 1, 1983, when the Secretary voluntarily dismissed her appeal from that decision. After the *DCHA* opinion, the Medicare fiscal intermediaries settled these plaintiffs' cost reports for years subject to the 1981 schedule, using a wage index that included federal hospital data.

On February 17, 1984, the Secretary published a proposed notice reissuing the wage index originally contained in the 1981 schedule of cost limits. 49 Fed. Reg. 6175

(February 17, 1984). On November 26, 1984, the Secretary, "after consideration of comments," issued a final notice reaffirming the use of the wage index that was used to calculate the June 30, 1981 schedule of cost limits. 49 Fed. Reg. 46495 (November 26, 1984). The November 26 Notice stated that it was "[e]ffective December 26, 1984" and applied to "cost reporting periods ending after September 30, 1981, as well as cost reporting periods beginning on or after October 1, 1981, and before October 1, 1982." *Id.* Fiscal intermediaries then applied this retroactive wage index to recoup monies previously reimbursed to plaintiffs for these cost reporting periods under the wage index that included federal hospital data.

Pursuant to 42 U.S.C. § 1395oo(f)(1), plaintiffs sought and obtained certification from the Provider Reimbursement Review Board ("PRRB") that it lacked authority to resolve the providers' challenges to the retroactive wage index rule. The parties do not dispute that the agency's determination thus constitutes a final decision properly before this Court for judicial review under applicable provisions of the APA, 5 U.S.C. § 701 *et seq. See* 42 U.S.C. § 1395oo(f).

II.

A.

Plaintiffs contend that the Secretary's retroactive wage index rule is invalid: (1) under Medicare Act provisions authorizing the establishment of Medicare cost limits; (2) under APA provisions and case law interpreting those provisions; (3) under the standards applied to determine whether rules should be given retroactive effect; and (4) for violation of the Secretary's own regulations on cost limits indicating that they are to be given *prospective* effect.

Plaintiffs first note that in 1972 Congress amended the Medicare Act—specifically 42 U.S.C. § 1395(x)(v)(1)(A)—to authorize the Secretary to establish Medicare cost limits. *See* Pub. L. No. 92-603, § 223(b). According to plaintiffs, an examination of the legislative history establishes that limits set under § 223 must be "exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. No. 92-231, 92d Cong., 1st Sess. 83 (1971); S. Rep. No. 92-1230, 92d Cong., 2d Sess. 188 (1972). Thus, plaintiffs assert, the Secretary's wage index rule is invalid because its retroactivity is contrary to the intent of Congress.

Plaintiffs' second contention is that the Secretary's action violates applicable APA provisions and case law interpreting the APA. Plaintiffs note that under the APA, a "rule" is defined as "the whole or part of an agency statement of general or particular applicability and *future effect* . . . ." 5 U.S.C. § 551(4) (emphasis added). Rules adopted under the APA "are prospective in application only." *Retail, Wholesale and Department Store Union, AFL-CIO v. NLRB,* 466 F.2d 380, 388 (D.C. Cir. 1972). Plaintiffs distinguish *adjudicative* rulemaking, which may under certain circumstances be given retroactive effect, from notice and comment rulemaking, which, plaintiffs assert, should not have retroactive application. *Compare Citizens to Save Spencer City v. USEPA,* 600 F.2d 844, 880 (D.C. Cir. 1979) (Supporting "the general principle that agency [notice and comment] rulemaking, whenever possible, should be prospective only in effect," but finding in the particular circumstances good cause for retroactive application).

Plaintiffs assert that even in the context of adjudicative rulemaking, retroactivity is disfavored. Our Court of Appeals has discussed the factors to be considered in determining whether a rule should be given retroactive application:

> (1) Whether the particular case is one of first impression,
>
> (2) Whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law,
>
> (3) the extent to which the party against whom the new rule is applied relied on the former rule,
>
> (4) the degree of the burden which a retroactive order imposes on a party, and
>
> (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.

Retail Union, supra, 466 F.2d at 390. Plaintiffs contend that examination of these factors yields the conclusion that the wage index rule should not be given retroactive effect.

Exploring the *Retail Union* factors, plaintiffs first quote from that opinion:

> Whether a case is of "first impression" is important because "to deny the benefits of a change in the law to the very parties whose efforts were largely responsible for bringing it about might have adverse effects on the incentive of litigants to advance new theories or to challenge outworn doctrines."

Plaintiffs' Statement of Material Fact Not In Dispute at 14 (filed October 21, 1985) (quoting *Retail Union, supra,* 466 F.2d at 390). Similarly, plaintiffs contend, it trivializes APA procedural requirements and significantly discourages litigants like plaintiffs if the Secretary can, after invalidation of a rule for procedural defects, simply engage in *pro forma* procedural corrections and retroactively re-issue the rule against those who successfully challenged it initially.

Regarding the second *Retail Union* factor, plaintiffs contend that the retroactive rule constitutes an abrupt departure from the previous practice of including federal hospital data in the wage index. Plaintiffs note that the result of the Court's action in *DCHA* in invalidating the 1981 schedule was to reinstate the previous index including federal hospital data:

> To "vacate," as the parties should well know, means "to annul; to cancel or rescind; to declare, to make, or to render void; to defeat; to deprive of force; to make of no authority or validity; to set aside." [Citations omitted.] Thus, by vacating or recinding the recissions proposed by ER-1245, the judgment of this court had the effect of reinstating the rules previously in force . . . .

Action on Smoking and Health v. CAB, 713 F.2d 795, 797 (D.C. Cir. 1983). Thus, plaintiffs assert, the *DCHA* decision invalidating the 1981 schedule reinstated the prior index including federal hospital data. That index continued in force until the unexpected retroactive application in late 1984 of the reissued wage index rule, which thus constituted an "abrupt departure."

Regarding other *Retail Union* factors, plaintiffs assert that they relied on the prior rule and expected that the Secretary would behave lawfully. They further assert that retroactive application clearly imposes a substantia burden on them, representing without contradiction that $400,000 was recouped from four plaintiffs and $1,000,000 from one plaintiff.

As to the final *Retail Union* factor, plaintiffs contend that no statutory interest supports retroactive application of the reissued wage index rule. Plaintiffs explore the merits of the reissued wage index rule and argue, supported by Bureau of Labor Statistics ("BLS") data, that the Secretary is erroneous in her belief that the wage index

rule excluding federal hospital data results in more accurate cost reimbursement. Plaintiffs contend that the Secretary has critically erred by failing to differentiate between hospitals in the urban "core" of an SMSA and those in the suburban "ring." Essentially, plaintiffs argue that they, as urban core hospitals, must compete for employees with federal hospitals in a manner that most suburban "ring" non-federal hospitals do not. Accordingly, exclusion of the federal data fails to account for market forces with significant impact on plaintiffs' costs and results in under-reimbursement. In support of this contention, plaintiffs recite BLS data that indicate that the wage index for non-federal hospitals in the urban core of the D.C. SMSA is 1.3286. The wage index for the entire SMSA, *including* federal hospitals, is 1.1953; the wage index for the entire SMSA *excluding* federal hospital data is 1.1547. *See* Plaintiffs' Statement of Material Facts, *supra* at 33. The Secretary's reissued rule applies the equivalent of the latter index—thus forcing plaintiffs even farther away from the index (the first) that accurately reflects market forces operating on their costs.

Plaintiffs further contend that the retroactive application of the wage index rule necessarily involves violation of the APA's requirement that published rules have a thirty day delayed effective date. *See* 5 U.S.C. § 553(d). The purpose of the thirty day delayed effective date rule is to "afford persons affected a reasonable time to prepare for the effective date of a rule or rules or to take any other action which the issuance of rules may prompt." S. Rep. No. 752, 79th Cong., 1st Sess. 15 (1946); H.R. Rep. No. 1980, 79th Cong. 2d Sess. 25 (1946). Retroactive application of the revised rule, plaintiffs contend, denies them this opportunity. Plaintiffs also contend that the Secretary has not provided an adequate basis and purpose statement supporting the reissuance of the rule.

Finally, plaintiffs contend that the Secretary's action violates his own regulations which require that cost limits be given *prospective* effect. Plaintiffs note that initial versions of 42 C.F.R. § 405.460(a), the cost limit regulations, promulgated on June 6, 1974, expressly stated that "[t]hese limits will be imposed *prospectively* . . . ." 39 Fed. Reg. 20165 (June 6, 1974) (emphasis added). The cost limit regulations were revised June 1, 1979; as revised, § 405.460(b)(3) stated:

> *Prior to the beginning of a cost period to which limits will be applied,* the Secretary will publish a notice in the *Federal Register,* establishing cost limits and exploring the basis on which they were calculated.

44 Fed. Reg. 31802 (June 1, 1979) (emphasis added). The preamble accompanying the amendments stated that the Medicare Act authorizes the Secretary "to set *prospective limits* on the costs that are reimbursed under Medicare." *Id.* (emphasis added). Thus, plaintiffs assert, the Secretary's action violates not only the Medicare Act and the APA, but the principle of "prospectivity" required by the Secretary's own regulations.

Plaintiffs also point to the Secretary's administrative decisionmaking, in which "prospectivity" is emphasized:

> When an event occurs during the cost year that both changes a provider's eligibility for a new classification and significantly increases the provider's costs, a reclassification would not violate prospectivity. *The criteria for setting the limits and the limits themselves would be established for all categories prior to the cost reporting period.* The criteria and the limits would not change during that period. That is all that prospectivity requires under the circumstances in this case.

Beth Israel Hospital v. Blue Cross Association, CCH Medicare and Medicaid Guide ¶ 31,645 at 10,136-10,137 (Nov. 7, 1981) (emphasis added).

B.

In response, the Secretary generally seeks to characterize the November 26, 1984 action as a simple reissuance of the 1981 schedule after correction of the procedural defects that initially prevented effectuation. The Secretary stresses that the Court's decision in *DCHA* did not preclude re-issuance of the wage index rule, and that retroactive effect is accorded rules when it is reasonable and in the public interest to do so. *See SEC v. Chenery Corp.,* 332 U.S. 194 (1947). The Secretary argues that the reissued wage index rule will more accurately reflect actual costs, and that to deny the reissued rule retroactive effect will permit plaintiffs to retain an unjustified "windfall."

The Secretary quotes this Court's statement that " '[i]t is both logical and precedented that an agency can engage in new rulemaking to correct a prior rule which a court has found defective.' " *Community Hospital of Battle Creek v. Heckler,* No. 84-0743, slip op. at 6 (D.D.C. Oct. 30, 1984), *quoting NAACP v. Donovan,* 737 F.2d 67, 72 (D.C. Cir. 1984).

Defendant contends that even if the reissued rule is perceived as a new rule, rather than a reissued "procedurally corrected" old rule, that retroactive application is justified after scrutiny of the *Retail Union* factors. The Secretary contends that the reissued rule does not constitute an "abrupt departure" from established practice as plaintiffs were forewarned by the issuance of the 1981 schedule that the Secretary intended to exclude federal hospital data from the wage index.

For the same reason, the Secretary argues that plaintiffs cannot reasonably claim to have relied to their detriment on the previous wage index. The Secretary notes that the 1981 schedule, although later invalidated, was in place before the cost reporting periods at issue and was not invalidated until April 29, 1983. Thus, the Secretary asserts, plaintiffs should have conducted their planning for the

relevant cost periods under the assumption that federal hospital data would be excluded.

Defendant contends that retroactive application will not unduly burden plaintiffs, as the wage index excluding federal hospital data more accurately reflects actual costs. Thus, the Secretary argues, rather than being unduly burdened by the retroactive application, plaintiffs are prevented from enjoying unjust enrichment.

As to the final *Retail Union* factor, defendant argues that his action furthers the statutory interest in reimbursing only those costs necessary in the efficient delivery of health services. The Secretary notes that 42 U.S.C. § 1395(x)(v)(1)(A)(ii) authorizes "suitable retroactive adjustments" when necessary to cure over- or under-reimbursement, and cites cases in which retroactive Medicare adjustments have been upheld. *See Fairfax Nursing Center, Inc. v. Califano,* 590 F.2d 1297 (4th Cir. 1979); *Adams Nursing Home of Williamstown, Inc. v. Mathews,* 548 F.2d 1077 (1st Cir. 1977); *Springdale Convalescent Center v. Mathews,* 545 F.2d 943 (5th Cir. 1977); *Hazelwood Chronic & Conv. Hosp. v. Weinberger,* 543 F.2d 703 (9th Cir. 1976).

On the merits of the reissued rule, the Secretary contends that the rule is substantively, as well as procedurally, valid. The Secretary quotes from the preamble to the 1981 notice:

> We concluded that the exclusion of Federal government hospital data would improve the accuracy of the wage index because most Federal hospitals characteristically employ physicians and other high salaried professionals whose salaries are based on national rather than local wage scales. This factor tends to overstate the average hospital wage in areas with Federal institutions as compared to areas without such Federal facilities. Since the purpose of the wage index is to reflect area-by-area differences in the labor-related component of hospital costs, the exclusion of Federal hospital data better enables the wage index to accurately reflect area-by-area labor-related costs.
>
> To the extent hospitals must pay employees wage rates similar to those of Federal facilities to attract qualified personnel, this competitive behavior is reflected in the non-Federal BLS data used to calculate the wage index. That is, if non-Federal hospitals in an area pay wage rates relatively equivalent with those of Federal hospitals, the exclusion of Federal wages would have little effect on the wage index. If wages paid to Federal hospital employees are higher than most area hospital wage levels, then the inclusion of Federal data results in most hospitals receiving a higher Medicare cost limit than is warranted based on their expected costs. Such a result defeats the purpose of the cost limits, which is to limit a provider's reimbursement to only those costs necessary in the efficient delivery of needed health services. Therefore, reissuance of the wage index excluding Federal hospital data reflects Congressional intent to limit hospital reimbursement to those costs necessary in the efficient delivery of services.

49 Fed. Reg. 6175, 6177 (February 17, 1984). While the Secretary does not dispute plaintiffs' claim that urban "core"/suburban "ring" differentiation might yield an even more accurate wage index, he contends that positive change may be accomplished piecemeal, and that core-ring differentiation requires more study before implementation.

The Secretary contends that many providers were benefitted by the wage index excluding federal hospital data, and that many comments received after the February 17,

1984 proposed notice favored implementation of the change. These providers, defendant asserts, would be substantially harmed by invalidation, as the fiscal intermediaries would be forced to open up past cost-reporting years and recoup funds reimbursed under the wage index excluding federal data.

Finally, the Secretary contends that plaintiffs could have applied for an exception under 42 C.F.R. § 405.460 (f)(8) from application of the wage index of which they complain. Section 405.460(f)(8) grants an exception to an individual hospital that can demonstrate that its percentage of labor costs varies by more than ten percent from the percentage used to calculate its area's limits. As plaintiffs did not apply for such exception, the Secretary suggests that they should not be heard to complain of application of the reissued wage index.

III.

Plaintiffs' motion for summary judgment is well taken. Under the circumstances of this case, the Secretary's reissued wage index is invalid insofar as it was retroactively applied to recoup monies paid to these plaintiffs under the wage index previously in force.

The fact that the November 26, 1984 wage index rule was retroactive cannot reasonably be denied. As plaintiffs correctly note, the effect of this Court's decision in *DCHA* was to render the 1981 schedule void *ab initio*, and to reinstate the previous wage index which included federal hospital data. The fiscal intermediaries recognized this when they settled plaintiffs' reimbursement for the cost years at issue using the wage index that included federal hospital data. The issues that are thus joined are (1) whether the Secretary was authorized to promulgate a rule with intended retroactive applications and (2) if so, whether retroactive application was justified in the circumstances of this case.

Addressing the first issue, it is not entirely clear that the Secretary is even *authorized* to apply a notice and comment cost-limit rule retroactively as was done in this case. Plaintiffs correctly note that the legislative history of § 223 of Pub. L. No. 96-603 indicates that limits set under § 223 are to be "exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. No. 92-231, *supra*, at 83; S. Rep. No. 92-1230, *supra*, at 188. Moreover, a "rule" under the APA is defined as "the whole or part of an agency statement of general or particular applicability and *future effect*," 5 U.S.C. § 551(4) (emphasis added), and our Court of Appeals has stated that rules adopted under APA notice and comment procedures "are prospective in application only." *Retail Union, supra*, 466 F.2d at 388. *See also Citizens, supra*, 600 F.2d at 880 (Supporting "the general principle that agency [notice and comment] rulemaking, whenever possible, should be prospective only in effect"). In addition, the Secretary's action does appear to violate 5 U.S.C. § 553(d)'s requirement that rules must have a thirty day delayed effective date. Finally, plaintiffs correctly note that the Secretary's own regulations, *see* 42 C.F.R. § 405.460(b)(3), and administrative decisionmaking stress the principle of *prospectivity* in cost limit pronouncement and application. *See Beth Israel Hospital, supra*, CCH Medicare and Medicaid Guide ¶ 31,645.

42 U.S.C. § 1395(x)(v)(1)(A)(ii), however, does authorize the Secretary to

> provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

Defendant correctly notes that this provision has been interpreted to authorize retroactive application of rules and recoupment based on cost years prior to the single cost year that preceded the promulgation of the rule. *See Fairfax Nursing Center, supra; Adams Nursing Home of Williamstown, supra; Springdale Convalescent Center supra; Hazelwood Chronic & Conv. Hosp., supra.* The scope of section 1395(x)(v)(1)(A)(ii) is far from settled, however; the Court of Appeals for the 9th Circuit has examined the legislative history and concluded that Section 1395(x)(v)(1)(A)(ii) did not contemplate that reimbursement principles could be changed and recoupment conducted *after* a cost reporting year has been completed and the provider's claims settled. *See Daughters of Miriam Center for the Aged v. Mathews,* 590 F.2d 1250, 1258-59 n.23 (3d Cir. 1978), *quoting* Hearings before the Senate Committee on Finance, 89th Cong., 2d Sess. 119 (1966).

It is unnecessary, however, to rest summary judgment for plaintiffs on the ground that the Secretary was not *empowered* to apply the reissued wage index rule retroactively to the cost years in question. Our Court of Appeals has stated with regard to the balancing of factors in evaluation of retroactive rulemaking:

> Which side of the balance preponderates is in each case a question of law, resolvable by reviewing courts with no overriding obligation of deference to the agency decision. [Citation omitted.]

Retail Union, supra, 466 F.2d at 390.

The *Retail Union* factors have been applied to determine the validity of retroactively applied "notice and comment" rules. *See Citizens, supra,* 600 F.2d at 881 n.185. Examination of those factors in this case compels the conclusion that the re-issued wage index must be invalidated insofar as it was applied retroactively to recoup monies reimbursed to these plaintiffs under the wage index that included federal hospital data.

The first *Retail Union* factor to be considered is whether a case is of "first impression." This is important because:

> to deny the benefits of a change in the law to the very parties whose efforts were largely responsible for bringing it about might have adverse effects on the incentive of litigants to advance new theories or to challenge outworn doctrines.

Retail Union, supra, 466 F.2d at 390. This general policy weighs strongly against permitting the Secretary to take the course upon which he has embarked in this case. It would stand the APA on its head and dramatically discourage litigants from contesting procedural deficiencies if the Secretary could, after invalidation of a rule, simply engage in *pro forma* procedural corrections and retroactively reissue the rule against those who challenged it initially.

The second *Retail Union* factor relates to whether the new rule is an abrupt departure from the pre-existing ones. The November 26, 1984 notice and its retroactive application dramatically departed from prior practice. This Court's decision in *DCHA* reinstated the wage index that included federal hospital data, and as late as July 10, 1984, the Secretary indicated in open Court that the Secretary had no present intention of recouping the monies reimbursed to plaintiffs under the pre-existing wage index, and future recoupment strategies were uncertain. *See* Administrative Record at 177. Under these circumstances, the retroactive application of the rule issued November 26, 1984 may fairly be described as an "abrupt departure."

The third *Retail Union* factor relates to whether the party against whom the new rule is applied relied on the old rule. While plaintiffs had perhaps been forewarned by the 1981 schedule of the Secretary's views on inclusion in the wage index of federal hospital data, this Court's *DCHA* opinion and the Secretary's representations on July 10,

1984 were sufficient that plaintiffs justifiably expected to retain the funds reimbursed to them after *DCHA* by fiscal intermediaries applying the wage index rule that included federal data.

The fourth *Retail Union* factor concerns the degree of the burden which a retroactive order imposes on a party. It cannot be disputed that the retroactive application substantially burdens plaintiffs. The Secretary does not contest plaintiffs' claims that over $1,400,000 has been recouped from them by fiscal intermediaries applying the retroactive rule.

Most significant, however, is the final *Retail Union* factor: whether any statutory interest supports retroactive application of the new rule so as to justify recoupment from these plaintiffs. The Secretary has not traversed plaintiffs' demonstration, employing BLS data, that the failure to differentiate between "core" and "ring" hospitals—coupled with the exclusion of federal hospital data—resulted in a wage index that *less* accurately reflected their costs than did the wage index which included federal hospital data. Accordingly, application of the reissued wage index rule to these plaintiffs would have resulted in under-reimbursement of legitimate costs—which would contravene the purposes of the Medicare statutes. The Secretary's argument that recoupment is necessary to prevent "unjust enrichment" is without foundation; plaintiffs represent without contradiction that they are not-for-profit hospitals and that their reimbursements were restricted to the lesser of *actual costs* or cost limits. Under such circumstances, plaintiffs can hardly be said to be "unjustly enriched" by invalidation of the Secretary's retroactive recoupment measures.

The Secretary's passing reference[1] to section 2316 of the

[1] *See* Memorandum of Points and Authorities in Support of Defendant's Motion for Summary Judgment at 18 n.15 (filed October 21, 1985). The Secretary actually referenced § 2311; it is assumed that he intended to refer to § 2316.

Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 1081 (1984), is not persuasive that a different result is required. Section 2316, enacted in the middle of the cost year beginning October 1, 1983, contemplated formulation of an improved wage index applicable to health care providers under the prospective payment plan. The section further contemplated that upon formulation of the improved wage index, adjustments would be made to payment amounts to providers for the cost year *during which* the required revised index was prepared. Such adjustments were to be made by decreasing or increasing payments in the succeeding cost period. Consequently, section 2316 does not strongly support the Secretary's action in 1984 in opening up for recoupment 1981 and 1982 cost years that have already been settled and expired several years before the retroactive wage index rule was promulgated. The fact that the Secretary first noticed in 1981 his intention to exclude federal hospital data from the wage index does not render the adjustment principles of section 2316 applicable in this case. The Secretary's 1981 schedule was rendered void *ab initio* and without effect by this Court's *DCHA* opinion. Thus, the 1984 retroactive wage index, unlike the revised prospective payment plan wage index contemplated by section 2316, reached back to cost years that expired several years prior to its issuance. Even more significantly, § 2316 by its terms justifies such payment adjustments by reference to the very problem which the Secretary has in this case failed to confront with sufficient particularity: the effect of area differentials and *relevant* labor markets on average hospital wage levels. These critical underlying principles render inapposite the Secretary's citation of section 2316 in support of his action in this case.

The Secretary's actions after *DHCA* suggest, as plaintiffs intimate, that the Secretary has trivialized the APA. Plaintiffs represent without contradiction that no com-

ments expressed favor for retroactive recoupment from those providers who had used the wage index including federal hospital data. Indeed, the February 1984 notice included no clear indication that the Secretary intended to apply the measure retroactively so as to effect such a recoupment. Such action in the face of comments opposed to it suggests that the notice and comment "procedural correction" was in critical respects simply *pro forma*. Such is the stuff of which arbitrary and capricious decisions are made.

The Supreme Court has clarified the general principles to be applied in determining whether new pronouncements should be given retroactive application:

> [R]etroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law.

SEC v. Chenery Corp., supra, at 203. Conversely, if the ill effect of retroactive application exceeds any "mischief" to the statutory design that would result from denying retroactive application, there should be no retroactive application. As has been demonstrated, *see supra* pp. 18-21, the balancing of factors in this case compels the conclusion that Medicare statute interests are only minimally served, if at all, by the Secretary's retroactive application of his reissued wage index to recoup funds from these plaintiffs. In contrast, the ill effects of the Secretary's action are substantial for these plaintiffs and for the general integrity of the administrative rule-making process. Accordingly, retroactive application against these plaintiffs must be denied.

This ruling does not overlook defendant's expressed concern that the ruling requires the Secretary to open up

and recoup funds reimbursed to providers who used the wage index that *excluded* federal hospital data. This concern is unwarranted. It may well be that the wage index excluding federal hospital data operates to the advantage of and better reflects costs for non-federal hospitals in suburban portions of SMSA's. Regulations and case law provide ample precedent for the Secretary to determine that a rule would not serve the statutory interests if applied in certain circumstances. For example, 42 C.F.R. § 405.460(f)(8), while not—as defendant contends—precluding plaintiffs from presenting other challenges,[2] does support the principle that the Secretary need not treat all individual hospitals under the same wage index rule when it would contravene statutory purposes to do so. *See also Regents of the University of California v. Heckler,* 756 F.2d 1387, 1397 (9th Cir. 1985):

> the Secretary must afford claimants the opportunity to demonstrate that the application of a particular rule to the facts of their case would produce a result that is contrary to the statutory mandate.

Moreover, "[w]here any administrative rule, although considered generally to be in the public interest, is not in the public interest as applied to particular facts, an agency should waive application of the rule." *P&R Temmer v. FCC,* 743 F.2d 918, 929 (D.C. Cir. 1984); *accord American Farm Lines v. Black Ball Freight Service,* 397 U.S. 532, 539 (1970). Thus, there is nothing in this ruling which requires the Secretary to recoup from those who have used a wage index which excluded federal hospital data.

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[2] Defendant does not persuasively traverse plaintiffs' demonstration that § 405.406(f)(8) would not have been available to them and that any relief accorded under that section would have been *de minimis*.

For all of the above reasons, the accompanying order will grant plaintiffs' motion for summary judgment, deny defendant's motion for summary judgment and declare the reissued wage index rule invalid insofar as it was applied to recoup monies from these plaintiffs. Defendant will be required to reimburse plaintiffs with interest for those funds recouped under retroactive application of the November 26, 1984 wage index.

/s/ LOUIS F. OBERDORFER
United States District Judge

Date: April 11, 1986

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 85-1845

GEORGETOWN UNIVERSITY HOSPITAL, ET AL., PLAINTIFFS

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

Civil Action No. 85-2545

HOWARD UNIVERSITY
AS HOWARD UNIVERSITY HOSPITAL, ET AL., PLAINTIFFS

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

Civil Action No. 85-2862

TUSCON GENERAL HOSPITAL, PLAINTIFF

v.

OTIS R. BOWEN,* SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, DEFENDANT

[Filed Apr. 11, 1986]

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* Otis R. Bowen is substituted for Margaret M. Heckler pursuant to Fed. R. Civ. P. 25(d).

ORDER

For the reasons stated in an accompanying Memorandum, it is this 11th day of April, 1986, hereby

ORDERED: that plaintiffs' motion for summary judgment should be, and it hereby is, GRANTED; and it is further

ORDERED: that defendant's motion for summary judgment should be, and it hereby is, DENIED; and it is further

DECLARED: that the retroactive wage index rule published at 49 Fed. Reg. 46495 *et seq*. (November 26, 1984), was and is invalid insofar as it was applied to recoup funds previously reimbursed to plaintiffs; and it is further

ORDERED: that, on or before April 25, 1986, defendant pay to the plaintiffs all amounts previously recouped from the plaintiffs based on defendant's retroactive wage index rule (including any interest charged by defendant during the recoupment process), plus interest (computed to the date of payment) in accordance with 42 U.S.C. § [illegible](f)(2).

/s/ LOUIS F. OBERDORFER
United States District Judge

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 86-5381
Civil Action No. 85-1845

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

No. 86-5382
Civil Action No. 85-2545

HOWARD UNIVERSITY
AS HOWARD UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

No. 86-5383
Civil Action No. 85-2862

TUSCON GENERAL HOSPITAL

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

Appeals from the United States District Court
for the District of Columbia

[Filed June 26, 1987]

JUDGMENT

Before: EDWARDS and STARR, *Circuit Judges,* and SWYGERT, **Senior Circuit Judge,* United States Court of Appeals for the Seventh Circuit.

These causes came on to be heard on the records on appeal from the United States District Court for the District of Columbia, and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by this Court, that the judgment of the District Court appealed from in these causes is hereby affirmed, in accordance with the Opinion for the Court filed herein this date.

Date: June 26, 1987
Opinion for the Court filed by Circuit Judge Edwards.

* Sitting by designation pursuant to 28 U.S.C. § 294(d)(1982).

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 86-5381

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

[Filed Sept. 1, 1987]

ORDER

Before: EDWARDS and STARR, *Circuit Judges,* and SWYGERT,* *Senior Circuit Judge,* United States Court of Appeals for the Seventh Circuit.

We have considered appellant's petition for rehearing in the above-captioned case. Appellant characterizes our opinion as holding that the Administrative Procedure Act imposes a "per se" ban on retroactive rulemaking. As a general rule, the APA requires that legislative rules be given future effect only. Whatever exceptions might exist to this general rule were not implicated in the case before us. Our opinion therefore does not purport to address circumstances in which there may be an exception to the rule against retroactive rulemaking.

It is therefore ORDERED, by the Court, that the petition for rehearing is denied.

* Sitting by designation pursuant to 28 U.S.C. Section 294(d).

Per Curiam
FOR THE COURT:
GEORGE A. FISHER, Clerk

/s/ ROBERT A. BONNER
By: Robert A. Bonner
Deputy Clerk

APPENDIX E

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 86-5381

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

v.

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, APPELLANT

[Filed Sept. 1, 1987]

ORDER

Before: WALD, *Chief Judge,* and ROBINSON, MIKVA, EDWARDS, RUTH B. GINSBURG, BORK, STARR, SILBERMAN, BUCKLEY, WILLIAMS, and D.H. GINSBURG, *Circuit Judges,* and SWYGERT,* *Senior Circuit Judge,* United States Court of Appeals for the Seventh Circuit.

Appellant's suggestion for rehearing *en banc* has been circulated to the full Court. No member of the Court requested the taking of a vote thereon. Upon consideration of the foregoing, it is

ORDERED, by the Court *en banc,* that the suggestion is denied.

* Sitting by designation pursuant to 28 U.S.C. Section 294(d).

Per Curiam
FOR THE COURT:
GEORGE A. FISHER, Clerk

/s/ ROBERT A. BONNER
By: Robert A. Bonner
Deputy Clerk

APPENDIX F

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 82-2520

DISTRICT OF COLUMBIA
HOSPITAL ASSOCIATION, ET AL., PLAINTIFFS

v.

MARGARET HECKLER, ET AL., DEFENDANTS

[Filed Apr. 29, 1983]

MEMORANDUM

I

For each of the even years before 1981, defendants have published an annual schedule of limits on hospital costs reimbursable under the Medicare Act only after publishing a notice of proposed rulemaking and receiving comments solicited by that notice, pursuant to the Administrative Procedure Act ("APA"), 5 U.S.C. § 553. On June 30, 1981, however, defendants published a "Final Notice" of the 1981 "Schedule of Limits on Hospital . . . Costs," 46 Fed. Reg. 33637 (June 30, 1981), without first publishing a proposed rule and receiving comments, despite the fact that the new 1981 schedule for the first time excluded the wages paid by "federal government hospitals" in each market area from the formula used to calculate reimbursable wage costs for that area. *See id.* at 33639.

In the 1981 Final Notice, defendants noted that because of this exclusion of federal wage data, the wage index for the 1981 cost limit schedule "differs . . . from the wage

index used in developing the 1980 hospital cost limits." *Id.* at 33638. The defendants explained their decision to exclude the data as follows:

> "Because these [federal government] hospitals typically use national pay scales, the amounts they pay their employees do not necessarily reflect area wage levels. We believe excluding data from these hospitals will help improve the accuracy of the wage index adjustment."

Id. at 33639. Defendants stated that this was a "minor technical change[ ]." *Id.* at 33638. They also stated, in justification of foregoing notice and comment, that it "would be contrary to the public interest to permit" 1980 cost limits to remain in effect any longer, *id.* at 33640, presumably, although the notice did not so indicate, because the 1980 limits led to higher hospital reimbursements and greater expense to the Medicare program.

Plaintiffs are three "not-for-profit" hospitals located in the District of Columbia and an association representing the interests of 15 similar hospitals in the District of Columbia. Apparently, neither the individual hospital plaintiffs nor the 15 hospitals represented by the association are "federal government hospitals." [1] There are, however, a relatively large number of federal government hospitals in the District of Columbia market area. Plaintiffs allege that they have been substantively damaged in two ways by the decision to exclude federal hospital wage data from the wage index for the 1981 Medicare hospital cost limits schedule. First, the new limit substantially reduces the

[1] All the plaintiff hospitals and "nearly all" of the association's member hospitals provide services under the Medicare and Medicaid programs. Complaint, ¶¶ 7, 11. As defendants note, with exceptions under one treatment program "[f]ederal government hospitals do not participate in Medicare." Defendants' Post-Hearing Memorandum (March 21, 1983) at 3, n.2.

income derived by plaintiffs from the Medicare program on account of services provided to Medicare patients.[2] Second, this decrease in reimbursement payments also allegedly reduces plaintiffs' ability to compete in hiring qualified personnel against the higher-paying federal hospitals in the area.

Plaintiffs' basis for suit, however, does not rest on their alleged monetary injuries or the substance of defendants' decision to exclude federal wage data from the 1981 wage index. Their challenge is solely procedural. Plaintiffs claim that defendants' failure to carry out notice and comment procedures before deciding to eliminate federal hospital wage data from the 1981 schedule violated the APA, 5 U.S.C. § 551 *et seq.* They therefore seek a declaratory judgment to this effect. They seek as further relief on this procedural claim an order vacating the 1981 cost limit schedule, enjoining defendants from excluding the federal hospital wage data from the calculation of reimbursements under the 1981 schedule, and requiring that any subsequent schedule that may be validly adopted after notice and comment be given prospective effect only. This prayer for relief will be dealt with below, separately from the procedural basis for the suit.

[2] According to plaintiffs, Children's Hospital Medical Center, Georgetown University Hospital and Greater Southeast Community Hospital "will incur" Medicare and Medicaid losses of $91,200, $278,100 and $423,000 respectively, "[s]olely as a result of the exclusion of the federal government hospital wage data from the wage index. . . ." Memorandum in Support of Plaintiffs' Motion for Summary Judgment (Oct. 7, 1982) at 7. Defendants argue that plaintiff hospitals can have no "expectation" or "reliance interest" in a particular level of reimbursement, so that these monetary allegations are improper. This may be true, but it is beside the point. Defendants do not contest the fact that, if federal wage data were included in the 1981 wage index, plaintiffs' reimbursement levels would be higher to some degree than if that data is excluded.

Defendants have moved to dismiss or in the alternative for summary judgment. They argue that this Court is without jurisdiction to review the decision by the Secretary of Health and Human Services to issue a final regulation without notice and comment, citing 42 U.S.C. § 405(h) (incorporated into the Medicare Act by 42 U.S.C. § 1395ii) and 42 U.S.C. § 1395oo (1976 & Supp. IV 1980).[3] Defendants further argue that, in any event, the Secretary had good cause to waive notice and comment for the 1981 schedule because exclusion of federal wage data was "a technical change" for which notice and comment procedures would have been "unnecessary and contrary to the public interest."[4] *See* Defendants' Supplementary Memorandum (Jan. 25, 1983) at 2-4.

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[3] Section 205(h) of the Social Security Act, 42 U.S.C. § 405(h), provides that:

> The findings and decisions of the Secretary after a hearing shall be binding upon all individuals who were parties to such hearings. No findings of fact or decision of the Secretary shall be reviewed by any person, tribunal, or government agency except as herein provided. No action against the United States, the Secretary, or any officer or employee thereof shall be brought under sections 1331 or 1346 of title 28 to recover on any claim arising under this subchapter.

42 U.S.C. § 1395oo, which will not be set forth here, sets up at length an administrative review mechanism for Medicare claims that may lead to judicial review once the mechanism has been exhausted. Plaintiffs have not attempted to initiate administrative proceedings under § 1395oo.

[4] Defendants do not argue that the annual cost limit schedule is not a "rule" subject generally to APA notice and comment requirements. Rather, they argue that *this particular change* (exclusion of federal wage data) was exempt under § 553(b)(B), which permits waiver of the rulemaking requirement for "good cause." Thus it is unnecessary to address plaintiffs' argument, which defendants do not controvert, that the 1981 change was otherwise subject to APA rulemaking procedures. It is conceded that such is the case. *See* Plaintiffs Memorandum in Support (Oct. 7, 1982) at 7-13; *see also Batterton v. Marshall*, 648 F.2d 694 (D.C. Cir. 1980).

In support of the latter argument defendants cite 5 U.S.C. § 553(b)(B), which provides for an exemption to the APA's notice and comment requirements "when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest."[5] According to defendants' Final Notice, although federal wage data was excluded for the first time in 1981, the Secretary used the "same methodology" to compute the 1981 wage index as had been used in earlier years. 46 Fed. Reg. 33638, 33640. Subsequently, defendants have characterized the exclusion of federal government hospital wage data as a "change in methodology," but one that was "minor and technical," so that notice and comment were "unnecessary" for purposes of the APA. Defendants' Memorandum of Points and Authorities (Nov. 22, 1982) at 17 (hereinafter "Points and Authorities"). At the same time, defendants urge that action without notice and comment served the public interest by protecting the public against payment of large "windfalls" to plaintiffs and other Medicare providers totalling "hundreds of thousands of dollars." Defendants' Supplementary Memorandum, *supra,* at 10; *see* Defendants' Points and Authorities, *supra,* at 25.

II

Jurisdiction is the threshold question. Our Court of Appeals has generally construed Section 205(h) of the Social Security Act (*see* note 3, *supra*) to bar federal court jurisdiction over claims seeking Medicare reimbursement.

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[5] Defendants do not argue that public participation was "impracticable" in this case. That obviously would be a difficult claim to sustain when defendants have previously used the notice and comment procedure in fixing these schedules for seven years.

Ass'n. of American Medical Colleges v. Califano, 569 F.2d 101 (D.C. Cir. 1977). Moreover, the detailed administrative review process for Medicare claims set out in 42 U.S.C. § 1395oo (*see* note 3, *supra*) generally must be exhausted before a claimant may seek review in federal court. *Id., see also Humana of South Carolina, Inc. v. Califano,* 590 F.2d 1070, 1080 (D.C. Cir. 1978). On the other hand, exhaustion is not required under these provisions and judicial review may lie *ab initio* (albeit with deference) when a lawsuit is brought "simply to vindicate an interest in procedural regularity." *Humana, supra,* 590 F.2d at 1080; *accord, National Ass'n. of Home Health Agencies v. Schweiker,* 690 F.2d 932, 936-37 (D.C. Cir. 1982), *cert. den.,* 103 S. Ct. 1193 (1983) (hereinafter "*NAHHA*").

Each party here struggles to fit the circumstances and precedents into categories advantageous to it. Plaintiffs emphasize that they make no monetary claims; they wish only to correct a violation of a fundamental requirement of the APA and seek a declaratory judgment by the Court on that theory. Defendants point to plaintiffs' additional prayers for injunctive relief barring defendants from applying to plaintiffs any wage schedule or wage schedule methodology different from that in effect in 1980, or from applying any new, procedurally valid, schedule retroactively. Defendants argue that this prayer for relief demonstrates that plaintiffs' only real interest is in the bottom line—a larger reimbursement when and if plaintiffs file their claims.

This is plainly not an "action brought to recover on any claim" within the specific terms of § 405(h). There has been no claim of which the Court is aware. Plaintiffs disavow any substantive challenge to the Secretary's wage index decision in this lawsuit, but rather claim the right under the APA to present their views to the Secretary for consideration in rulemaking. Plaintiffs' Memorandum in

Opposition (Dec. 20, 1982) at 2. Thus it is clear that this is not a dispute "over the amount properly reimbursable," and therefore that relief under § 1395oo is not available nor is its pursuit required for jurisdiction here. *See NAHHA, supra,* 690 F.2d at 938-39; *Humana, supra,* 590 F.2d at 1080-81.

Plaintiffs have, of course, criticized the substantive rationality of defendants' decision to exclude federal hospital wage data from the relevant formula. As a matter of policy, they disagree with that decision. But as a matter of law, they make this argument only to show how the omission of notice and comment proceedings deprived them of an opportunity to apprise the Secretary on the rulemaking record of relevant facts and considerations that might have led the defendants to a different result, or at least subsequently permitted the plaintiffs to argue to a reviewing court that the result the Secretary reached was irrational. Thus the claim pressed here by plaintiffs is essentially that of a party "aggrieved" by a rulemaking consummated without notice and comment. It is a claim made available under the APA to any person aggrieved by administrative action. Hopes of increased reimbursement may underlie plaintiffs' pursuit of an opportunity to comment to the Secretary about the change and may be, in that sense, plaintiffs' "motivation for bringing this lawsuit." *NAHHA, supra,* 690 F.2d at 938. But the point of law at issue is vindication of their statutory rights to have notice of and to comment on administrative decisions that affect them. Those rights have values of their own, independent of any claim for reimbursement: "increased fairness" to affected parties, and provision to the Secretary of "valuable information concerning the various issues involved." *NAHHA, supra,* 690 F.2d at 950; *see also Small Refiner Lead Phase-Down Task Force v. U.S. Environmental Protection Agency,* No. 82-2282, slip op. at 85 (April 22, 1982). Plaintiffs are entitled to judicial con-

sideration of their challenge to possible denial of these values, irrespective of whether favorable resolution would ultimately support a separate administrative claim for reimbursement, or not.[6]

Defendants appear to suggest that whenever a monetary interest can be traced to the plaintiffs in a Medicare case, there can be no immediate federal jurisdiction. Defendants' Points and Authorities, *supra,* at 14-15. This is a strained and unrealistic interpretation of the statutes and relevant precedent. In both *Humana* and *NAHHA,* it was clear that plaintiffs challenging particular decisions of the Secretary on procedural grounds were doing so because of the ultimate fiscal impact which those decisions might or would have on them. Indeed, the sort of injury necessary for standing in a federal court is unlikely to ever be entirely separated from monetary interests in a Medicare case. Congress's intention to prevent judicial interference with the Secretary's substantive decisionmaking concerning particular monetary claims in the Medicare program can and must be reconciled with its intention in passing the APA to permit those regulated by unelected federal agencies to receive some procedural process prior to exercise of the regulatory power. That end is accomplished by finding immediate federal jurisdiction over procedural claims while barring such jurisdiction over substantive monetary challenges. Thus our Court of Appeals in *NAHHA* distinguished between a plaintiff's "ultimate goal" and his "motivation," and indicated that only claims "*directly*

[6] Although it is not the basis for the Court's decision, defendants themselves have, as already noted, characterized the change that plaintiffs challenge as one in "methodology." Our Court of Appeals has suggested that substantive challenges to the "method" of determining claims, as opposed to the "amount" of such claims, may be heard by courts in the first instance. *NAHHA, supra,* 690 F.2d at 938; *see Riverside General Hospital v. Schweiker,* 548 F. Supp. 1137, 1141-42 (D.D.C. 1982).

related to a claim for reimbursement" can and must be reviewed under § 1395oo. 690 F.2d at 938 (emphasis supplied). When such alternate forms of judicial review are unavailable as in a procedural case like this one, the law in this Circuit is that § 405(h) does not preclude federal jurisdiction over federal claims. *Id.* at 940-41. The legal rights normally provided under the APA cannot be cut off by the language of § 405(a) or § 1395oo unless expressly indicated by Congress, and the Court is aware of no such express indication.

This conclusion is not altered by consideration of the 1980 amendment to § 1395oo that specifically authorized expedited judicial review of "a question of law and regulations" where the Medicare administrative review board "determines that it is without authority to decide the question." 1980 Omnibus Budget Reconciliation Act, Pub. L. No. 96-499, § 955, 94 Stat. 2599, 2647 (1980). This argument was made by the Secretary and rejected by our Court of Appeals in *NAHHA, supra.* The Court of Appeals ruled there that the 1980 amendment was directed only at claims "otherwise reviewable under the statute." 690 F.2d at 939. Here, as there, plaintiffs' claim is a procedural one not cognizable under the statute, and it "cannot be characterized as a reimbursement dispute." *Id.*[7] Accordingly,

[7] Moreover, the Secretary has already made the decision to forego notice and comment for the 1981 schedule; that decision has been considered, reaffirmed and defended in this proceeding. The Secretary's decision to forego notice and comment must be considered on the grounds offered at the time of the decision, i.e., the grounds that appear at 46 Fed. Reg. 33637-44 (June 30, 1981). *S.E.C. v. Chenery Corp.,* 332 U.S. 194, 196 (1947); *Portland Cement Association v. Ruckelhaus,* 486 F.2d 375, 395 (D.C. Cir. 1973) (Leventhal, J.), *cert. den.,* 417 U.S. 921 (1974); *cf. Lanphear v. Prokop,* No. 82-1388, slip op. at 11 (D.C. Cir. April 1, 1983). Thus it would be an exercise in futility to decline jurisdiction over the notice and comment issue now, only to have to consider it again on these same grounds after it has gone through the administrative mill.

defendants' motion to dismiss for lack of jurisdiction will be denied.

III

There remains for consideration defendants' contention that the exclusion of federal hospital wages was a "minor technical change" which was exempt from notice and comment under the "good cause" exemption of the APA. 5 U.S.C. § 553(b)(B). The "good cause" exemption relied upon by defendants does not operate upon mere incantation, as defendants appear to suggest, *see* Supplementary Memorandum, *supra,* at 2-3, and a court cannot accept an agency's finding of "unnecessary" on faith alone. The exemption of § 553(b)(B) is to be "narrowly construed" and reviewing courts should "examine closely proferred rationales justifying the elimination of public procedures." *A.F.G.E. v. Block,* 655 F.2d 1153, 1157 n.6 (D.C. Cir. 1981); *see Council of Southern Mountains, Inc. v. Donovan,* 653 F.2d 573, 580 (D.C. Cir. 1981).

The argument that public participation was "unnecessary" does not survive even deferential scrutiny. When Congress enacted § 555(b)(B), it explained that

> " '[u]nnecessary' means unnecessary *so far as the public is concerned,* as would be the case if a minor or merely technical amendment *in which the public is not particularly interested* were involved."

S. Rep. No. 752, 79th Cong., 1st Sess., at 16 (1945), reprinted in *Administrative Procedure Act—Legislative History* 200 (U.S. Gov't. Printing Office 1946) (emphasis supplied). " '[P]ublic interest' supplements the terms 'impracticable' and 'unnecessary,' " and only "lack of public interest in rulemaking warrants an agency to dispense with public procedure." *Id.* Thus it is the *public's* perception of a rule change, and not the agency's, that must govern. The institution of this lawsuit, as well as the conceded fact that

"hundreds of thousands of dollars" are at issue, indicate that at least a portion of the public is very interested in defendants' decision, and would have taken advantage of the opportunity to comment if it had been afforded.

Moreover, defendants are caught in contradiction when they leap from a description of the wage index change as "minor" to their argument that notice and comment would have been "contrary to the public interest." Defendants argue that the change in the formula was so insignificant that it produced only a "very limited . . . small impact." Points and Authorities, *supra,* at 21-22. Yet they also argue that the public interest justified acting without awaiting public participation because the new schedule would save the public money and protect against "windfalls" totalling "hundreds of thousands of dollars." This contradictory rationale is the stuff of which arbitrary and capricious decisions are made.

Defendants' assertion that public participation in developing the 1981 wage index was "unnecessary" or "contrary to the public interest" overlooks the fact that plaintiffs and the public had no opportunity to provide information about the potential impact of the exclusion. The decision was clearly a controversial one, and plaintiffs have demonstrated that the Secretary may have been unaware or even mistaken about some facts central to the decision.[8] Defendants' description of the possibility of increased payments to plaintiffs as "windfalls" thus begs the very question that proper notice and comment procedures could have addressed and resolved.

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[8] For example, the defendants did not have a list before them of all federal government hospitals when deciding to exclude their wage data, thus making precise calculation of the fiscal impact difficult. *See* Plaintiffs' Second Supplemental Memorandum (March 1, 1983) at 2. Defendants may have also erred in their assumption that federal govenment hospitals "typically" set their wages according to "national pay scales." *Id.* at 2-3. *See also* Plaintiffs' Memorandum in Support (Oct. 7, 1982) at 16-20.

Moreover, the administrative agencies that determine provider reimbursement claims are now bound by the Secretary's decision to exclude federal wage data. The decision thus made law, binding on the agency which administered it, without even the limited process that notice and comment would have afforded. *See Batterton v. Marshall,* 648 F.2d 694 (D.C. Cir. 1980); *Joseph v. U.S. Civil Service Commission,* 554 F.2d 1140, 1157 (D.C. Cir. 1977).

On the basis of the foregoing and other badges of arbitrariness and caprice identified by plaintiffs in their memoranda, the Secretary's decision to exempt the exclusion decision from notice and comment must be declared unlawful. Consequently, with regard to the exclusion of federal wage data that plaintiffs challenge, the 1981 schedule was, and is, invalid.

IV

The question of remedy remains, and presents a more difficult problem. Defendants urge that even if the federal wage data exclusion decision was invalid for lack of public participation required by the APA, the 1981 wage index and schedule should remain in effect as promulgated unless and until a new index is properly promulgated utilizing notice and comment. Such a result would be contrary to the normal remedy in an APA case. Our Court of Appeals has noted that "[n]ormally, a judicial determination of procedural defect requires invalidation of the challenged rule." *Batterton, supra,* 648 F.2d at 711. The APA itself states that a "reviewing court *shall* . . . hold unlawful *and set aside* agency action . . . found to be . . . without observance of procedure required by law." 5 U.S.C. § 706(2)(D) (emphasis supplied). *See also Chrysler Corp. v. Brown,* 441 U.S. 281, 313 (1979).

On occasion courts have exercised their equitable discretion to keep procedurally invalid regulations in place for a

short time until new regulations could be properly promulgated. *See, e.g., Rodway v. U.S. Dept. of Agriculture,* 514 F.2d 809, 817-18 (D.C. Cir. 1975); *U.S. Steel Corp. v. E.P.A.,* 649 F.2d 572, 577 (8th Cir. 1981); *Western Oil & Gas Ass'n. v. E.P.A.,* 633 F.2d 803, 813 (9th Cir. 1980). These cases and others that defendants cite, however, were characterized by factors counselling in favor of maintaining invalid regulations that are *not* present here: emergency situations or wholesale disruption of critical government programs, and lack of a prior regulatory scheme to operate to in place of the invalid regulations. *See Rodway, supra,* at 817 (food stamp regulations of "critical importance" affecting "over ten million American families"); *A.F.G.E. v. Block, supra,* 655 F.2d at 1157 ("emergency regulations" had been required by prior court order); *Asarco, Inc. v. O.S.H.A.,* 647 F.2d 1, 2-3 (9th Cir. 1981) (per curiam) (arsenic exposure standard where exposure poses "serious health risk"); *Western Oil & Gas, supra,* 633 F.2d at 813 (Clean Air Act regulations for entire state of California); *U.S. Steel, supra,* 649 F.2d at 577 (same for Minnesota).

In this case, invalidation of the 1981 wage index and formula would leave in place the formula that was arrived at after proper notice and comment procedures and was used successfully to reimburse providers prior to July 1981. The only difference would be that federal wage data would be included in the index. Invaliding the 1981 wage index therefore would not substantially disrupt defendants' administration of the Medicare program. And the equities do not weigh as clearly in defendants' favor as defendants suggest. As noted above, defendants' characterization of higher payments to plaintiffs as "windfalls" or "unjust enrichment" begs the question and frustrates the purpose of notice and comment. Likewise, the argument that invalidation would "thwart the operation of the law" begs the question of what the law requires: the inclusion of

federal wage data does not violate any express statement of the Medicare law as it appears in the statutes, whereas defendants' conduct in promulgating the 1981 schedule clearly violated the APA.

Therefore, were it not for the jurisdictional thicket that obscures Medicare cases, both precedent and equity would point toward immediate invalidation and vacation of the 1981 wage index due to defendants' clear violation of APA. Yet it is clear that to invalidate the 1981 wage index and enjoin defendants from retroactively applying any new schedule that excludes federal wage data might well permit plaintiffs to recover a larger amount of Medicare reimbursement than they would under the present 1981 schedule. Indeed, plaintiffs claim that they stand to lose about $500,000 "solely" due to the exclusion of federal wage data from the 1981 schedule. An injunction such as plaintiffs request would leave defendants no discretion; they would be bound to include federal wage data when determining plaintiffs' reimbursement amounts. Thus, unlike the situation in *NAHHA,* in this case "[g]ranting the requested relief *will* [or at least may well] . . . enable [plaintiffs] to receive larger reimbursements." 690 F.2d at 939 (emphasis supplied). This would be more nearly the "direct" result of the injunction than in previous cases, without resort to the remedies under § 1395oo.

The Court is therefore presented with the following puzzle: To render the full relief that plaintiffs request, i.e., invalidate the 1981 wage index and enjoin its application by defendants to plaintiffs' claims, would in this case directly determine that plaintiffs must receive Medicare monies from defendants that plaintiffs might not otherwise receive. Yet the Medicare statutes preclude jurisdiction over an unexhausted Medicare claim that would lead directly to an increased amount of reimbursement to a provider. On the other hand, the APA and interpretative cases indicate that, absent special factors not present here, plaintiffs

should be granted the relief they seek. An unlawfully promulgated regulation should be invalidated *ab initio*; otherwise, "the rulemaking provisions of the Administrative Procedure Act are completely trivialized." *N.L.R.B. v. Wyman-Gordon,* 394 U.S. 759, 781 (1969) (Harlan, J., dissenting) (quoted with approval in *Independant U.S. Tanker Owner Committee v. Lewis,* 690 F.2d 908, 921 (D.C. Cir. 1981)); *see also Independant U.S. Tanker Owners, supra,* 690 F.2d at 926 ("The only way to ensure that [APA violations] will not continue is to refuse to accept the decision resulting from [them]."). Thus, although the Court has jurisdiction under the APA to consider plaintiffs' procedural claim, its jurisdiction to render the full relief requested is in doubt.

After much consideration, it must be concluded that proper operation of the unique judicial review scheme created by Congress for Medicare claims would be most faithfully employed by denial of the injunction that plaintiffs request. Accordingly, the accompanying Order will declare that defendants' promulgation of the 1981 wage schedule without providing notice and comment on the decision to exclude federal government hospital wage data from the wage index violated the provisions of the APA, and that, consequently, the 1981 schedule was and is invalid insofar as it incorporated the unlawfully promulgated wage index. The effect of this declaration, however, upon determination of reimbursement levels for Medicare providers after June 30, 1981, must be determined in the first instance by the Secretary and her delegates administering the claims procedure; they are, of course, obligated to follow the law as it is finally interpreted by the Court. Plaintiffs can file any cost reimbursements claims they believe they have according to the administrative relief mechanism set up in § 1395oo. The Provider Reimbursement Review Board ("PRRB"), which also must follow the law, will then have the opportunity to consider

the effect of this Court's declaration on plaintiffs' claims; its decisions are in turn reviewable by the Secretary. Only after the Secretary makes her decision, or the PRRB determines that it has no authority to decide the effect of this Court's declaration on reimbursement claims, will jurisdiction lie in federal court again with respect to plaintiffs' claims for a particular level of reimbursement. *See* § 1395oo(f)(1).

The accompanying Order will not enjoin defendants from applying the 1981 schedule to plaintiffs' claims for reimbursement, although it will declare that the wage index used in that schedule was promulgated unlawfully and is consequently invalid. Plaintiffs may pursue their specific reimbursement claims administratively armed with that declaration, and may seek judicial review if they are dissatisfied with the PRRB's or the Secretary's ultimate determination. If the Secretary wishes to put in place a valid prospective wage index, she should begin proper notice and comment proceedings; any wage index currently in place that has been promulgated without notice and comment is invalid as was the 1981 schedule.[9]

/s/ LOUIS F. OBERDORFER
Date: April 29, 1983 United States District Judge

[9] Although defendants published an annual wage schedule from 1974 through 1981, the parties have not apprised the Court as to whether a new schedule was promulgated in 1982 or will be forthcoming in 1983. The 1981 Final Notice provided that the 1981 schedule would, with automatic adjustments, continue to apply in 1982 absent further action, *see* 46 Fed. Reg. at 33644, and defendants have referred in a footnote to the "1982 limits." Defendants' Points and Authorities, *supra,* at 7 n.6. If a schedule subsequent to the 1981 schedule was properly promulgated under the APA, then no new rulemaking is required. If notice and comment procedures have not been followed since 1980, however, as the parties' silence suggests, then the schedule has been invalid since its unlawful promulgation on June 30, 1981, and cannot be given lawful effect until proper rulemaking procedures are completed.

APPENDIX G

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 82-2520

DISTRICT OF COLUMBIA HOSPITAL ASSOCIATION, ET AL., PLAINTIFFS

v.

MARGARET HECKLER, ET AL., DEFENDANTS

[Filed Apr. 29, 1983]

ORDER

For the reasons stated in the accompanying Memorandum, it is this 29th day of April 1983, hereby

ORDERED: that defendants' Motion to Dismiss or in the Alternative for Summary Judgment is DENIED; and it is further

ORDERED: that plaintiffs' Motion for Summary Judgment is GRANTED; and it is further

ADJUDGED, DECEED and DECLARED: that defendants' decision to exclude data from federal government hospitals in developing the wage index used in the 1981 schedule for Medicare hospital cost limits, published at 46 Fed. Reg. 33638-33644 (June 30, 1981), *as amended* 46 Fed. Reg. 46406-07, without providing prior notice and comment proceedings, violated the rulemaking provisions of the Administrative Procedure Act, 5 U.S.C. § 553, and was unlawful; and it is further

ADJUDGED, DECREED and DECLARED: that, in consequence of defendants' unlawful failure to comply with the Administrative Procedure Act, the 1981 schedule

for Medicare hospital cost limits, insofar as it incorporates or was formulated by using a hospital wage index that excluded data from federal govenment hospitals, was and is invalid; and it is further

ORDERED: that defendants shall promptly place a notice in the *Federal Register* advising that the 1981 schedule for Medicare hospital cost limits has been declared invalid with regard to the wage index.

/s/ LOUIS F. OBERDORFER
United States District Judge

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